FUNDING RETIREMENT FOR PROFESSIONAL INSTRUCTORS

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SUMMARY

Professional Taekwon-Do instructors are self-employed owners of small businesses. They do not have the benefits of specialists employed by corporations. This includes common employment benefits, such as pension schemes.

The ITF cannot create the infrastructure to do these things for professional instructors – it would be far too inefficient for a small international entity to develop efficient global structures. Instead, the ITF should arm instructors with the information they need to act themselves, and measure their success based on the actions of those instructors. Therefore, the ITF should educate its instructors financially – in budgeting, debt management, wealth protection, accumulation and decumulation.

This thesis focuses specifically on accumulation – investing for retirement. It outlines some core investment fundamentals, such as compound interest, risk and return, and asset allocation and diversification. It describes key investment tips, such as the importance of a good financial adviser, start investing early, and increase the amount you invest as your means improve. The educational content of this thesis would be useful for professional instructors if it were converted to a booklet of about four pages of infographics to communicate its concepts quickly and effectively.

Ultimately, I recommend that Taekwon-Do instructors seek financial advice to invest in pension funds offered in their own countries. Instructors should begin investing now, if they haven't already.

INTRODUCTION

Although specific details differ across countries, life in a capitalist society follows a common path: barring misfortune, a person is born, educated, works, retires, dies. During working life, a person accumulates wealth. After retirement, a person spends (or "decumulates") their wealth. There is a challenge to accumulate enough wealth during working life to last between retirement and death.

The challenge gets harder as we live longer. In many countries, a child born today has a life expectancy nearing 100 years. A person who retires at the national retirement age can often expect to live a further 30 years! How much does it cost you to live each year? Take this cost and multiply it by 30 – that's a lot of wealth to accumulate. Now add to that the cost of your medical bills as you age. Health deteriorates with age until a person is ultimately bedridden before death.

How can we fund this retirement? Specifically, how should retirement be funded for Taekwon-Do instructors? We could consider three options:

1. Draw on the wealth of others to fund your retirement.
2. Sell your Taekwon-Do business as a source of wealth.
3. Save or invest during your working life to fund your retirement.

DRAW ON THE WEALTH OF OTHERS

During our working lives, we participate in an active economy. As professional Taekwon-Do instructors, we create value (teaching Taekwon-Do), in exchange for value (training fees). This is the essence of a capitalist society. There is integrity for the actors in this system – when I take your money, I give you something of value in return.

When we retire, we no longer create value. But we still need money to survive. When we rely on the wealth of others, we justify our actions based on the value we created for the economy in our past – but we were already paid for that. Should we be paid again? Where is the integrity in that?

Many nations provide a safety net of basic income for the elderly. This is funded by taxes, which we pay during our working lives. When a society feels that the elderly should have basic care, every working person shares in these costs, and every working person expects to benefit in their own retirement; there is integrity in the system.

Sometimes private entities try the same system. The masses pay for the few. However, the system lacks integrity, because not all of the masses will benefit from the system in the future. This type of funding is very nearly a pyramid scheme, where the people at the bottom fund those at the top without those at the top creating value for them. Pyramid schemes are illegal in many countries.

In the ITF, such a system would create its own challenges – as the ITF matures, we will create more and more Grand Masters. A major flaw in a pyramid scheme is the requirement to continually grow the income base to fund a growing top. Ultimately pyramid schemes collapse when they fail to grow the base sufficiently.

I argue that while professional Taekwon-Do instructors will benefit from any safety net that exists in their domicile, they should not rely on the wealth of others to fund their retirement.

Sell your Taekwon-Do school

In a capitalist society, a common source of wealth is to spend your working life building an asset of value (a business) and sell the asset to others at retirement to extract its wealth.

Selling a Taekwon-Do school is even more challenging than selling another type of business because the market for buyers is very small. We only want to sell our schools to a qualified International Taekwon-Do instructor who will care for our students the same way we do. That is a very small pool. And then you must find such a person who is willing to pay you a good price. The buyer must expect to build your business to even greater value to justify the purchase price, so they also need to be a sound entrepreneur. Your pool of potential buyers is very small indeed.

Commonly we spend our latter working years trying to find and develop our own successor, and encourage them to take the business over at a fair price. If we are lucky, we may be succeeded by our children, but few manage to achieve this.

While this is a good strategy for professional Taekwon-Do instructors, it is highly risky, and it should not be your only strategy.

Fund your own retirement through saving and investment

Most capitalist nations have some form of private pension system to help people fund their own retirement. During your working life, you invest some of your income to accumulate wealth. When you retire, you draw on this wealth. There is a great deal of integrity in paying your own way.

Usually the system is facilitated by employers, sometimes by governments, and sometimes both. In the United States, the government system is commonly called the 401K, and corporate jobs usually include a pension; Australia has the compulsory Superannuation Guarantee Contribution, and every employee contributes almost 10% of their earnings to their own superannuation scheme; New Zealand has KiwiSaver, an optional personal superannuation scheme.

The problem for professional Taekwon-Do instructors is that they are not employed by corporations, so they are often left to implement retirement savings alone – and many don't do it. Although this is the best way for a professional Taekwon-Do instructor to fund retirement, most will leave it until it is far too late.

The ITF should educate and encourage instructors to start early to save for their own retirement.

That is the focus of this paper.

Often Taekwon-Do instructors don't want to retire. We love what we do, and we want to be like General Choi, who taught almost until his death at 83 years old. However, none of us know our futures. It is possible that a health or other event may render you unable to teach into your old age.

Disclaimer: this paper does not constitute personalized financial advice. For advice relevant to your own circumstances, I recommend you consult a suitably qualified financial adviser.

RECOMMENDATIONS

The ITF should actively promote financial literacy and capability in its instructors. This includes training and resources. It should even involve qualification and testing. Financially capable instructors will be more successful, and will grow the ITF. They will also live happier and more secure lives. The educational content in the remainder of this paper could be converted to about four pages of clear infographics, to communicate the content quickly and effectively.

The ITF should actively train instructors to fund their own retirements. The more we prepare our instructors to fund their own retirements, the better the whole lives of our instructors will be. This is the responsibility of an ITF that cares for its instructors.

Professional instructors should use the retirement savings regimes in their own countries to invest for retirement. It is very inefficient for the ITF to create an international retirement savings scheme. Instead the ITF should educate instructors about the importance of retirement saving, and the fundamentals of investment. The ITF should encourage instructors to use local retirement savings regimes to invest for their own retirements.

Financial literacy and capability

The foundation of financial security is financial education, and the earlier in a person's life that this begins, the more secure they will be.

Many Taekwon-Do instructors are not experienced business people. They fall into a Taekwon-Do career because of their skill in teaching, not their financial acumen. Therefore, for each Taekwon-Do instructor we must start now.

Financial literacy requires skills in various areas:

1. Budgeting
2. Debt management
3. Wealth protection
4. Accumulation
5. Decumulation.

Moreover, specialists argue that financial literacy is insufficient. We require financial *capability*. Knowing what to do is only part of the solution, *doing it* is essential.

Here is a very important rule for financial capability:

> *Get help.*

We won't all be financial specialists, and finance gets very complex. If you don't understand the details of a financial product, get financial advice. Very importantly, get financial advice from someone independent of the person or company trying to sell you the product.

The five areas listed above are outlined briefly in this section. The remainder of this paper focuses on accumulation.

Budgeting

Here is the first rule of successful personal finances:

> *Spend less than you earn.*

That is not to say you should never borrow – businesses may need to borrow money to get started, for example. Rather, regular spending should be less than regular income. Live within your means. Your standard of living should improve as your income grows, not before it grows.

Budgeting is the secret to living within your means. A budget is a plan of income and expenditure. Professional instructors should have separate budgets for their Taekwon-Do businesses, and for their personal finances.

Most instructors should be able to produce a list of types and amounts of monthly income and expenditure. An annual budget is also important to account for expenditure that occurs less frequently than monthly. Revisit the budget regularly for two reasons: are you spending within your budget, and does the budget need to be adjusted?

Debt management

Spending other people's money is not free. Debt comprises of principal (the amount you borrowed) and interest (additional money calculated as a portion of the amount borrowed that you pay to the lender as a return).

Use debt wisely.

To understand debt, you must understand its costs – fees, and interest. Depending upon the integrity of the lender and the laws of the country, these costs can be clear and transparent, or hidden and opaque. Always seek to understand the effective annual interest rate. This can be compared across lenders, and the cost of debt can be more easily calculated. In many countries, some lenders will disclose what seems like a low interest rate, but state the rate per week or month; 2% per week is a staggering 180% per annum! Additionally, lenders may charge establishment fees, discharge fees, and other types of fees.

There are good ways and bad ways to borrow money. Credit cards are a bad way to borrow money – interest is very high, and paying the minimum amount due will never get you out of debt. (They can be a convenient transaction tool, so long as you pay the entire balance at the end of each month.) Short term debt (for example, a few weeks) is also a bad way to borrow money. High fees as well as interest mean the effective cost of this type of debt is very high.

Long-term secured borrowing is usually the cheapest. That means you tell the lender they can sell a specific asset to get their money back if you don't pay it. This gives the lender confidence that they will get their money back, and lower risk means they are usually willing to charge less. The more stable and valuable the asset, the more security for the lender. A mortgage on your house is more reliable than your future business income.

Don't use debt to fund a lavish lifestyle. Debt is most sensibly used to generate income greater than the cost of debt (business debt), or to buy a secure personal asset (a house).

Ensure your budget tells you that you can service and repay the debt, and always have a plan for how long it will take to repay it.

If you don't understand the terms of the debt, seek independent financial advice.

Wealth protection (insurance)

Throughout life, there are risks that bad things can happen. Anything from natural disasters destroying your house or dojang, to car accidents, personal injury, disease, or premature death of you or a family member.

Insurance is a way of reducing financial loss caused if a risk eventuates. If you could cope financially with a particular risk eventuating, it may be possible to "self-insure" (take the risk, and if the event occurs, pay the costs). In all other cases, insurance policies can save you from financial ruin.

Unless you can bear the cost if a risk eventuates, insure the risk.

Insurance is basically pooling risk. If 100,000 people each pay $1 to cover a risk, and the event happens to one of them, there is a pool of $100,000 to cover that person's loss. The amount each person pays is the premium.

The most common types of insurance to cover major risks are:

- Personal insurance
    - Income protection. Usually your most valuable "asset" is your ability to earn future income. Income protection insurance pays a regular income in the event the insured person is unable to work, due to injury or disease, for example. This doesn't just apply to the breadwinner – if a homemaker is unable to work, how will the family cope? Ensure that you know whether to buy an agreed value or indemnity policy. For fluctuating income, an indemnity policy is likely to be unsuitable.
    - Life insurance. This pays a lump sum to the policyholder if the insured person dies. Again, if a homemaker dies, the financial impacts on the family can be severe, as the breadwinner takes a larger role at home and is less able to earn income.
    - Trauma / critical illness insurance. This pays a lump sum if the insured person contracts a medical condition that is listed in the policy.
    - Personal liability. What if you harm someone else and you are liable to pay their costs? Personal liability insurance can pay these costs in many circumstances.
- Health insurance
    - Medical care is expensive. In some countries it is funded by the state, and individuals don't pay. In some countries, state hospitals provide emergency and acute healthcare, but individuals must pay for non-essential medical care. In other countries, individuals must pay their own health costs. Unless the state pays for everything, and gets you treatment when you need it, health insurance is valuable. The appropriate level of health cover varies – policies might cover major events, specialists and tests, doctors' visits, dental care – and prices increase as more is covered.
- General insurance
    - This covers insurance policies to protect assets, such as your house, contents and car. This type of insurance is often foremost for many. Is your car as important as your ability to earn future income? If you insure your car, it is essential that you also insure you.
- Travel insurance
    - Most personal, health and general insurance policies only cover costs incurred in your own country. Costs of medical care overseas, in particular, can be crippling. Always take travel insurance when you travel. Some credit cards include travel insurance, but read the policy carefully, because it may not offer the cover you expect.
- Business insurance
    - Many types of personal and general insurance policies are relevant to businesses as well. This includes insurance to cover assets, insurance against liability if the business is responsible for harm or costs to another, and insurance to cover costs to maintain the business if a key person becomes ill or dies.

Insurance is a complex area, and the wording of a policy dictates exactly what it covers and what it doesn't. Unless you have the time and capacity to understand the details of a policy, seek independent financial advice.

Insurance needs also change over time, so you should regularly review your wealth protection needs with your financial adviser.

Accumulation (saving and investing)

In the 40 or 50 years of a person's working life, the person must accumulate enough wealth to live for the remaining 30 or so years of retirement. This period of saving or investing is called "accumulation". The longer you save, and the more you save, the more comfortable your retirement will be.

The challenge we must overcome is our present bias. We have trouble prioritising our future selves, because it seems so removed from who we are today. This means that consumption today seems more valuable to us than saving for tomorrow. Would we change our behaviour if we knew that the new car we bought today would mean we couldn't afford treatment for a medical condition we will develop when we are 80? What if we knew we could afford that medical treatment if we bought a cheaper, second-hand car today?

Most people must not only be taught how to save for retirement, but also be convinced to prioritise their future selves.

Once they are convinced, they need to learn *how* to save. While it is possible to save money in a bank, capitalist economies reward those who invest in successful businesses far more than banks pay in interest. Investment is discussed later in this paper.

Decumulation (spending in retirement)

Once a person retires, they begin to spend their accumulated wealth. This has a significant risk – longevity risk. How long will you live? Will you run out of money before you die? A good financial adviser can help you plan how much you can spend, and also continue to invest your unspent wealth so it continues to earn money.

There are also products to mitigate longevity risk. Some pension funds (called "defined benefit schemes") pay you income until you die, instead of a lump-sum when you retire. Many countries also have "annuity products" available, where you pay a large sum initially in return for a regular income until you die.

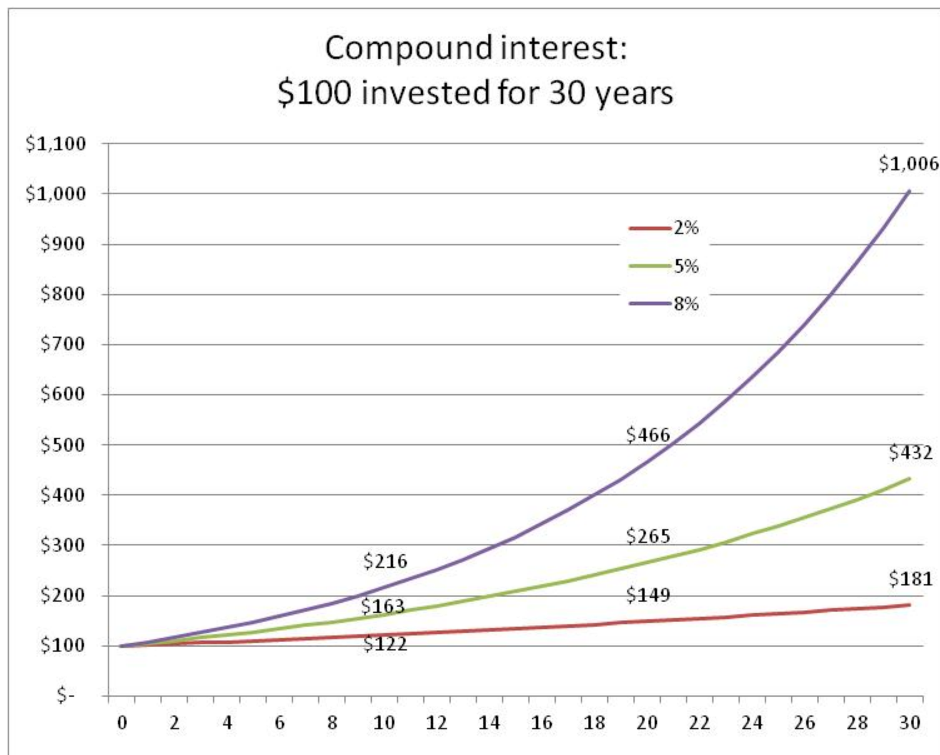
INVESTMENT BASICS

This section covers some of the fundamental concepts of investment.

COMPOUND INTEREST

The principle of compound interest is simple: when you lend or invest money, the recipient pays you money – interest or return. If you leave that money invested, the recipient pays you money on the interest or return, as well. What isn't so intuitive is just how big an impact this can have. Figure 1 provides an example.

FIGURE 1: COMPOUND INTEREST EXAMPLE



If $100 is invested with a 5% return for 30 years, it will be worth $432. At 8% return, it will be worth $1,006 – ten times your initial investment in 30 years! In fact, there is a very handy mathematical trick to tell you how long it takes to *double* your money: divide the number 72 by the interest rate or rate of return. For example, if you invest $10,000 at 6% return, 72 ÷ 6 = 12, so in 12 years it will double to $20,000. In 24 years, it will double again to $40,000!

Compound interest can work for you (if you invest) or against you (if you borrow). This is why you should only borrow to generate income, or buy secure personal assets. Avoid borrowing for things you want but don't need.

Risk and return

In investment, risk is the uncertainty of return – the amount you actually earn may differ from what you expect. Often there is even a chance that you could lose some, or all, of your original investment.

If you could choose between two certain returns, one paying 5% and another paying 10%, you would choose the one paying a higher return – and so would every rational investor.

Alternatively, what if you could choose between two investments where one guarantees to return 5%; the other would return 5% if you flip a coin and get heads or 0% if the coin shows tails? You would choose the guaranteed return. The other offers the possibility of the same return, but at greater risk.

If the options were 5% guaranteed, or 10% for heads and 0% for tails, what you choose would depend upon your attitude to (and understanding of) risk. Both options have the same *expected* return, but the latter option has a higher potential return and greater risk.

The greater the uncertainty of returns, the higher possible return investors will demand to take the risk. Investing is done in an open market, so low risk investments yield lower expected return, and high risk investments yield higher expected return – and a greater chance of loss.

This is why investing will give you a better expected return than saving. Putting money in a bank has high certainty (depending upon the quality of the bank), and therefore pays lower returns. Investing involves greater risk, and usually offers greater expected returns – often much greater.

Your risk profile

People have different attitudes towards risk. A person's attitude to investment risk is known as their "risk profile". There are many tools online to help you understand your own risk profile. Some ask a series of questions to understand your attitude to risk. Better tools try to understand your risk profile by giving you a series of tasks, and analysing how you act, because how we behave often differs from how we think we will behave.

Generally, the less comfortable you are taking risk, the more conservative your ideal investment strategy, and the lower your expected return.

However, investment returns tend to be more volatile in the short term, and increase over time. The longer the period you will invest, the more risk you can afford to take – so long as conservative investors have a financial adviser who can help them maintain their investment strategy when things look bad in the short term.

Figure 2 shows the cumulative value of 500 major companies in the US share market over 90 years (called the "S&P 500 Index"). There are clear periods – sometimes decades – when the value fell. The longer the period of investment, the less impact this volatility has on the value of the investment. Note that during this 90 year period, even when prices fell, 30 years later they were up. (Also notice that the scale of the chart, on the left axis, is not linear.)

FIGURE 2: VOLATILITY OF RETURNS EXAMPLE

source: http://www.macrotrends.net/2324/sp-500-historical-chart-data

Risk aversion, loss aversion and ambiguity aversion

Scenario 1: consider these two options. You can take $5,000 now, or I could flip a coin. If it is heads you get $10,000, on tails you get $0. Which would you choose?

Scenario 2: consider these two options. You can give me $5,000 now, or I could flip a coin. If it is heads, you must give me $10,000, on tails you don't have to give me anything. Which do you choose?

The impact of both scenarios is the same. You can choose $5,000 impact on your finances, or take a 50:50 chance of a $10,000 or $0 impact. Yet many people will choose differently in the two scenarios. The first scenario measures your "risk aversion" – your attitude to taking risk to make money. The second scenario measures your "loss aversion" – your attitude to the risk of losing money.

Your attitude to risk and loss will vary depending upon the value at risk. Redo these two scenarios in your mind, but this time change the values to $50 and $100. Do your answers change? What about at $50,000 and $100,000?

Now what if I didn't tell you I'd flip a coin. What if I told you there was "a chance" of $10,000 or $0, but I didn't tell you what that chance was. Your attitude towards known risk versus unknown risk is called "ambiguity aversion", or "uncertainty aversion".

Your risk aversion, loss aversion and ambiguity aversion will influence the types of investments that best suit you.

INFLATION AND TAX

Two things that reduce what you earn from investments are inflation and tax.

INFLATION

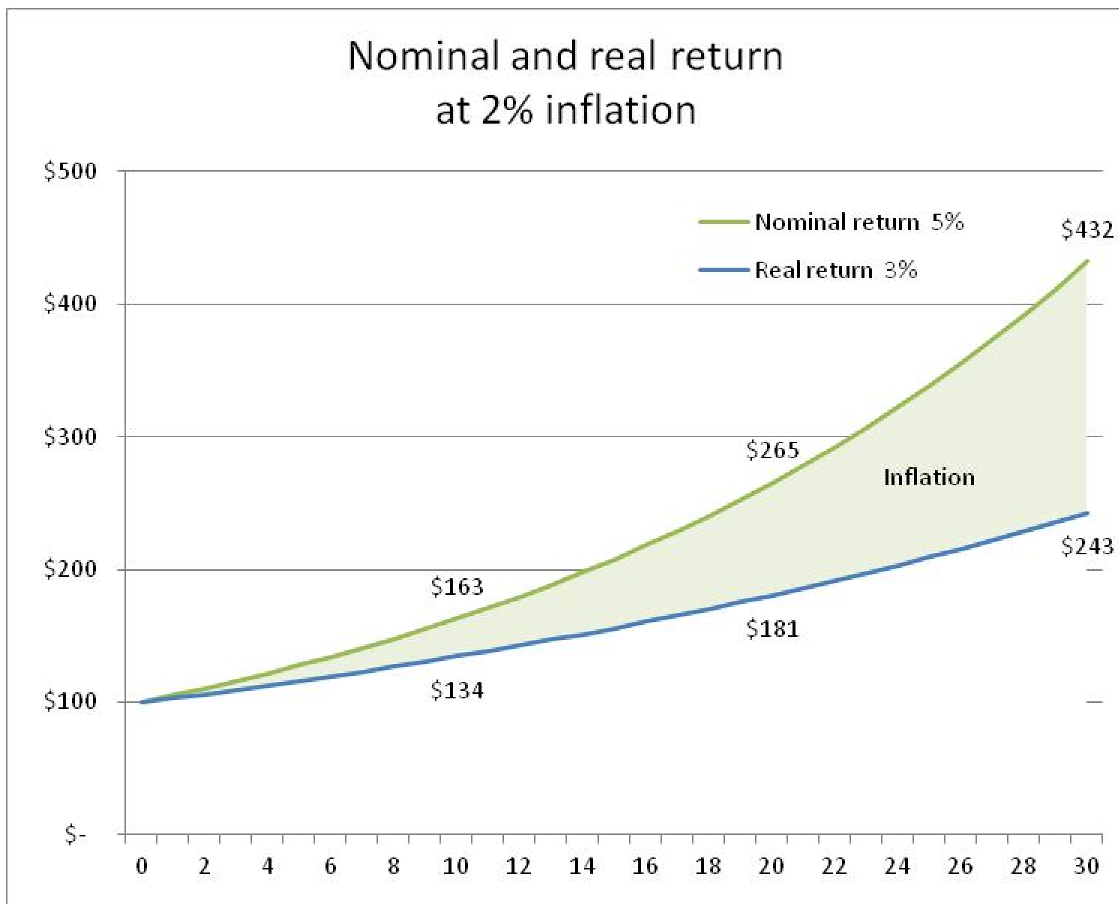
Inflation is the rate at which prices increase over time. In a working economy, modest inflation is desirable: when prices slowly rise over time, it encourages people to buy things they want now, rather than in the future when they will cost more. People buying things creates jobs for people to make those things, so with modest inflation, jobs are created and the economy expands.

Inflation is also a cost of investment. If something that costs $100 now will cost $120 when you retire, you need your $100 to be worth at least $120 when you retire – ideally much more than $120. The price you pay for something at the time you buy it is called the “nominal” price, in this example $100 today or $120 when you retire. The price without inflation is called the “real” price, in this example $100.

When you invest for retirement, you focus on your real return. This gives you a better idea of what you will be able to buy with your retirement savings.

Figure 3 shows the impact of inflation on the purchasing power of an investment. If you invest $100 at 5% return and 2% inflation, in 30 years you will have $432, but prices have risen. Your $432 will only buy then what you can buy for $243 today.

FIGURE 3: NOMINAL AND REAL RETURN EXAMPLE



Tax on investments

Tax is a complex area, and different countries have different taxation regimes on retirement savings. Sometimes different investment regimes within the same country can be taxed in different ways, so it helps to know how it works. Generally they fall into three types, known as “TTE”, “EET”, and “EEE”. The three letters refer to putting money in, returns, and taking money out; “T” is taxed, and “E” is exempt. Thus:

- “TTE” systems tax the money you invest, and tax the returns you make. They don’t tax you when you withdraw your money.
- “EET” systems don’t tax you when you put money in, and don’t tax your returns. Instead, they tax the money you withdraw. Although it feels harsh when you get less money than you withdraw, you can be better off, because during accumulation you get the benefits of compounding returns on money that TTE systems take from you as tax.
- “EEE” systems don’t tax your investment returns at all. These are great for the investor, but not for the government, so they are uncommon.

With investments, the amount you invest is called the “capital”. If the value of what you buy increases, this is a “capital return”. Many countries have a “capital gains tax”, to tax you on the increased value of your investment.

Investments may also return an income, or “income return”. Most countries tax that with “income tax”.

Asset classes and diversification

One of the most important rules of investment is so important and so renowned, that there is a common saying about it:

Don’t put all of your eggs in one basket.

This means you should diversify your investments. If you invest all of your money in one company, and the company fails, you lose everything. If you invest all of your money in a handful of similar companies, and the industry suffers a shock, you could lose a lot of money. If you invest all of your money in one market, country or region, and that market, country or region suffers a shock, you can lose a lot of money. So you should spread your investment across:

- Asset classes
- Regions, and countries within regions
- Sectors, and industries within sectors.

Asset classes

Asset classes refer to different types of investments. Generally, some asset classes are considered riskier than others, but this is not always the case. The most common asset classes are:

- ***Cash***. This includes bank call accounts and similar assets that can be converted to cash quickly. They generally provide a very low return.
- ***Debt or bonds***. This is when an investor lends money to a country, state, or company. Bonds usually pay a steady stream of interest (or "coupon"), and they can be sold to other investors. Bonds of countries like England and the United States are less risky than those of countries like Argentina. The riskiness of bonds is measured by a risk rating, which is given by a rating agency such as Standard & Poor's, Moody's or Fitch Group. Bond ratings are divided into "investment grade", and "non-investment grade" or "junk bonds". Investment grade bonds are less risky than junk bonds.
- ***Stocks, shares or equities***. These are part ownership in a company. As a part owner, you share in the company's profits and losses, as "dividends". Although shares are generally considered more risky than bonds, many companies are very robust and operate in stable industries, and can be less risky than many bonds. Growth companies (those in new and growing industries, or new companies in existing industries) are generally more risky, and have higher potential return. Shares are often traded, and the goal is to sell shares at a higher price than your original purchase price.
- ***Property and infrastructure***. This is generally more risky than people expect. Many investors live in countries where they have never seen property values fall, and they find this difficult to comprehend. The challenge with property and infrastructure is not only fluctuating value, it is also difficult to sell these assets quickly if you need cash. Property can be commercial, residential, or industrial. Infrastructure is large assets required for urban living, such as roads.
- ***Derivatives***. These assets are "derived" from other asset types. They are based on the promise to do something with another asset if or when an event occurs, and they are usually more risky than the "underlying asset". For example, "I will buy your shares in Amazon on 30 June 2020 for US$2,000 each." If the price is $2,500 per share on 30 June 2020, I do very well, but if it is only $500, I lose a lot of money. Derivatives come in many forms, with names like "forwards", "futures", "options" ("call options" or "put options"), and "swaps".
- ***Alternative assets***. Some professional investors trade in commodities, precious assets, currency and other unusual assets. Commodities are things like iron ore, coal, and milk powder that are used to make other things. Their value is determined by how much other companies want them, and how much is available. Precious assets include gold and silver, and sometimes artworks or classic cars. The main reason to invest in these assets is to sell them at a higher price to another person later (although precious metals have commercial uses, too). Investing in currency exists because of global trade. Companies and individuals need foreign currency, and investors can buy and sell currency aiming to profit from trading it in future.

These assets can be traded on a public exchange ("listed") or traded directly between buyers and sellers ("unlisted"). Common exchanges for equities include the New York Stock Exchange (NYSE) and NASDAQ in the USA, London Stock Exchange (LSE) in the UK, Deutsche Börse in Germany, Australian Securities Exchange (ASX) in Australia, and Shanghai Stock Exchange, Hong Kong Stock Exchange and Shenzhen Stock Exchange in China and Hong Kong. The advantage of exchanges is they bring together many buyers and sellers, so it is quicker to buy and sell assets. This is called "liquidity".

Regions and countries

The types of assets described above can be acquired in any capitalist country, and even many quasi-capitalist countries (such as China). Investors divide the world into various regions, which have similar characteristics. Although countries are interdependent, different economies expand and contract in different cycles. Diversified portfolios contain investments in various regions and countries, so the investor isn't beholden to the economic cycle of a single country. Investment research company Morningstar divides the world into 10 regions:

- North America. USA and Canada.
- Latin America. Includes all countries in Central America and South America.
- United Kingdom.
- Developed Europe. Generally Western European countries such as Germany, France, Italy and the Scandinavian countries.
- Emerging Europe. Generally Eastern European countries such as Poland, Russia and the Ukraine.
- Africa and the Middle East. Includes all African countries, and Middle Eastern nations such as Egypt, Israel and the United Arab Emirates.
- Japan.
- Australasia. Australia and New Zealand.
- Developed Asia. Includes Hong Kong, Singapore, South Korea and Taiwan.
- Emerging Asia. Includes most Pacific nations, and Asian countries such as China, Vietnam and India.

Investing in different countries requires buying and selling foreign currency, often in large amounts. Currencies can be volatile, and many investors prefer not to take this extra amount of risk. If an investment is "hedged", it means the investor buys currency derivatives to reduce currency risk. For example, they might buy a contract to buy or sell a foreign currency at a future date, at a price they agree when the contract is formed. Investments can be "unhedged", "partly hedged" or "fully hedged".

Sectors and industries

It is also important to diversify investments across sectors and industries (a sector is a group of industries). Companies within a sector often follow similar cycles, and changes in technology can reduce the value of entire industries very quickly. Research company Morningstar divides industries into 11 sectors:

- Basic materials. These are industries producing chemicals, building materials and paper products.
- Communication services. These include fixed-line and wireless networks, such as telephone and internet companies, and internet-related software and services.
- Consumer cyclical. This sector includes retail stores, auto industries, residential construction, restaurants and entertainment.
- Consumer defensive. Companies in this sector produce food and beverages, household and personal products, and packaging.
- Energy. This includes all industries related to oil and gas.
- Financial services. These industries include banking, investment, credit and insurance.
- Healthcare. All industries involved in healthcare, such as hospitals, pharmaceuticals, medical equipment and supplies.
- Industrials. Companies that manufacture machinery, tools and industrial products.
- Real estate. Companies in this sector include property management companies, and real estate investment companies.
- Technology. Companies that design and develop operating systems and applications, technology consulting, and companies that manufacture computers and components.
- Utilities. Electricity, gas and water companies.

Asset allocation

Deciding how much to invest in each asset class, region and sector is called asset allocation. Often asset allocation is even more important than the particular assets selected, and this is an area of particular skill – some research suggests that more return is earned from asset allocation than from asset selection. The goal is to maximise potential return for a minimum amount of risk, according to the investor's goals and risk profile.

Seek independent financial advice to determine the best asset allocation for your circumstances.

Types of fees

Fees reduce the value of your investment, and reduce the benefit of compound returns. It is important to understand all of the fees you pay for your investment, and the total cost. Often fees are expressed as percentages, which can obfuscate the amount you pay. Always ask to see the amount of fees in your local currency (dollars, Euros, or pounds, for example).

Fees expressed as a percentage are a portion of your entire investment, not a portion of the amount your investment increased. Therefore, in periods of low return, fees can be higher than your returns, and you will pay fees even if the value of your investment falls.

Some types of fees are explained below:

- When you first invest in something, you might be charged an "establishment fee", and when you close the investment you might be charged a fee to close your account.
- Some fees are charges when you put money in or take money out of your investment. These may be called "buying margins" or "selling margins" and are often expressed as a percentage of the amount you invest.
- "Transaction fees" are incurred when you buy or sell investments. They may be a fixed amount per transaction, or a percentage of the transaction value. In addition, if you are buying or selling investments in other currencies, there is a difference between the value of the currency (called the "spot rate"), and its buy price and its sell price (called the "spread"). The difference between the rate you get and the spot rate is an additional fee that is often hidden.
- If your investment is managed on a "wrap platform" (computer software to keep your investments together and provide reports), you may be charged a "platform fee".
- There may be an "advice fee" (the amount your adviser charges), and a "management fee" (the amount your investment manager charges). Sometimes these are charged as fixed sums, but often they are charged as a percentage of your investment. In addition, managers and advisers may charge you a "performance fee" – if they earn you more return than the market overall, they might charge you a share of it. (Be careful with performance fees, because they can be very complex.)

TOP INVESTMENT TIPS

With a basic understanding of investing, here are some useful tips to improve your outcomes.

SEEK FINANCIAL ADVICE

Investment is a complicated area. Part of the challenge is accepting that hindsight is always 20:20. Have you ever thought, "I should have bought shares in Google ten years ago," or "if I'd bought some bitcoin in 2013, I could have repaid the mortgage now." When we look back at the history of an asset's value, it is common to think we could have predicted it. It is very unlikely that you could have. This is called "hindsight bias". What will Google be worth 10 years from now? What will bitcoin be worth in 2020? It is not easy.

Get advice from a professional. Professional advisers are not fortune tellers. They don't invest all your money in "the next big thing". They follow sound principles of investing to maximise your potential return at a level of risk that you are willing to accept.

Here are some things you will want to know to help you find a good financial adviser. Many countries have public lists of financial advisers. It is also common to find a financial adviser from a friend's recommendation. Obtain testimonials from a few of the advisers clients. Talk to a few different financial advisers before you choose one. Here are some questions you can ask the adviser:

- What are your qualifications? You may hear Certified Financial Planner, Chartered Financial Analyst, or qualifications earned in your own country.
- Are you a member of a professional body? Search the internet for adviser associations or professional bodies in your country.
- Tell me about your experience. Does the adviser have experience working with clients similar to you? Can you talk to some of those clients?
- What type of advice do you provide? Will the adviser tailor advice to your particular circumstances? Does the adviser consider a range of different products from different companies, or only the products of one company?
- How much will it cost? How are you paid? Advisers may charge you directly. In many countries, it is common for advisers to be paid by the companies whose products they sell. They may be paid commission on the initial sale, and ongoing "trail" commission as long as you own the product. You will want to be certain they are recommending products for your benefit, not because the company pays them the most commission.
- How will the adviser keep you informed? How frequently can you access performance information? Ask the adviser to show you through some example reports, and ensure you can understand them.
- Are there any penalties or fees if you stop using the adviser's services? Are you agreeing to use the adviser's services for a minimum term?
- If you already have a financial product, and your adviser recommends you replace it with a new product, ensure they explain clearly the risks and benefits of doing so. How are they paid if you change, and if you don't change?
- Who has custody of your money, and how trustworthy is that party? Does your financial adviser ever have access to your money? Is the custodian related to your financial adviser in any way, or is the custodian completely independent?
- Does your financial adviser require a licence in your country? Can you verify that they have the appropriate licence? What about other parties with whom they work (such as the custodian of your money and assets)? Does everyone hold the appropriate licences?

Start investing early

The earlier you start investing, the longer your investment term, and the more money you will earn. If you invest $10 every week from age 40 at 5% return, when you reach 65, you would have over $25,000. If you start at age 20, you would have over $85,000! This is the power of compound interest.

The wrong time to start investing is tomorrow. Any delay can reduce your outcome, so if you haven't already started, set time aside in the next week to begin. It is very much like starting Taekwon-Do: the earlier you start, the better; if you haven't already started, the best day to start is today, no matter how old you are.

Save more tomorrow

Generally our income increases as our career progresses or our business grows. While it would be great to invest most of your income when you are young so you can benefit from compounding returns, it isn't practical. Instead, save what you can today, and as your income increases, put aside an increasing portion of your income.

For example, imagine you start work earning US$500 per month. You can afford to invest 5% of it, US$25 per month, and you need the other US$475 to live. Perhaps in a year, your income increases to US$550 per month. You know you can live on US$475, but you deserve to improve your living standards. Invest half of the increase, and increase your living standards with the other half – now you are investing US$50 per month. If your income increases to US$600 per month two years later and you do the same thing, you are now living on US$525 per month, and investing $75 per month – three times as much as when you started. Your standard of living is improving, and you are investing well for your retirement.

Commonly people ask how much they should invest for a comfortable retirement. This is a difficult question. It depends upon the lifestyle you want in retirement, how long you are likely to live, the cost of medical bills and care as you age, and the expected level of returns from your investments. Some rules of thumb suggest about 15% of your income throughout your working life. However, this is a very general heuristic. Take advice from your financial adviser. The usual working life is 40 to 45 years, and you can spend 20 to 30 years in retirement – about half as long as you spend working!

"Buy low and sell high" is not as easy as it sounds

One of the most important rules of investing is that an investment that performed well last year will not necessarily perform well next year: past performance is not an indicator of future performance. Often the opposite is true – investors saw an opportunity and bought into an asset when the price was low. Once the price is higher, the investment isn't such great value – you missed the opportunity.

Therefore, one of the worst things an investor can do is move their money into something that has already performed well. Unless you understand the underlying economics of the investment's value, and you believe that the investment remains priced below its value, don't reallocate your money there. Don't chase past performance. This is the role of a good investment manager, and they spend their careers trying to understand the underlying value to predict what will happen in future. Unless you have time to devote to this, let the professionals do it.

There is tremendous skill (and some luck) in identifying valuable investments while the price is low. All too often investors do the opposite. They see the value of an investment increasing over time, and buy in when the price is high. Then when the market corrects and the value of the investment decreases, many investors panic and sell to limit their losses. The natural human tendency is to buy high and sell low, which is how you lose money, rather than grow your investment.

Indeed, one of the most important things a financial adviser can do for you is help you overcome these natural human tendencies, and maintain your investment strategy.

Think of asset prices the same way you think of a new television – buy it on sale. When an asset price is high, why would you buy it when it is expensive? When markets decline, they are on sale – it is time to invest!

NET RETURN IS KEY

The most important number to consider over time is your return after all fees and expenses, "net return". However, the future is uncertain, and it is difficult to predict future returns.

Some things are certain, such as fees. High fees will reduce your return regardless of fund performance. So many investment commentators recommend minimising fees. Many advisers (especially those with high fees) will argue that net return after fees is more important than fees – why are they confident that they will earn sufficiently higher return to cover their fees?

Various types of fees were outlined on page 17, such as buy and sell margins, transaction fees, foreign exchange spreads, platform fees, advice fees, management fees and performance fees. With all of these different types of fees, tell your financial adviser that you want a summary of all of the fees you pay each year. You want to see it in your local currency and as a percentage of your investment. Shop around to ensure you are getting the best value for money.

Understand all of the fees you pay, in local currency.

Often the most useful information is qualitative. How experienced are the investment managers? How robust are their investment processes? For example, is there an investment committee that oversees investment strategy and execution? What research do they use? Your financial adviser may have access to good qualitative information that they can explain to you, and in some countries this information is publicly available.

Research suggests that it is very difficult for an investment manager to perform better than other investment managers consistently over time. If an investment manager performed better than others recently, they are unlikely to continue to do so. However, if an investment manager consistently underperforms other investment managers, research suggests that they are likely to continue to underperform.

BE CAREFUL TO AVOID INVESTMENT SCAMS

Unfortunately there are unscrupulous people in the world who prey on the naivety of investors. Some of this activity is legal, albeit immoral. Other activity is illegal. For example, there are so-called "boiler rooms" in some countries who telephone or email people randomly to try to scam them out of their money.

If it sounds too good to be true, it probably is.

Many countries have reputable entities, such as government financial markets regulators, who publish known scams. Before you agree to anything, start with a thorough web search and try to learn more. (Don't just use the website provided to you by the person offering you the investment!)

There are new investment scams rising all the time, so if you can't find anything, it doesn't necessarily mean an entity is trustworthy. Scams often follow similar patterns, so look for similar "investment opportunities" that are reported as scams. If the person offering the investment suggests you must provide money urgently, ask yourself why. Scammers use urgency to ensure investors don't have time to identify the illegitimacy of a scam.

Talk to your financial adviser before investing in an unsolicited "investment opportunity".

FUNDING YOUR RETIREMENT

So what is the best way to save for your retirement? For those who are not active investors, the best solution is often a good financial adviser, and a pension fund. This section outlines pension funds and managed funds, the most popular forms of retirement saving.

MANAGED FUNDS AND PENSION FUNDS

Researching and choosing good investments is a time-consuming vocation, and there is an industry of professionals who do this for others. They pool the money of thousands of investors with similar risk profiles, and invest the money together. These pools of money are called “managed funds” or “mutual funds”. A managed fund created as a retirement vehicle is called a “pension fund”. Pension funds are often “locked”, which means investors put money in regularly, but they are not allowed to withdraw it until they reach the agreed retirement age.

In many countries, a pension fund is part of the common employment package for jobs with large companies. Problematically, professional Taekwon-Do instructors do not work for large companies, and they may not have a pension fund provided. Therefore, professional Taekwon-Do instructors must act to invest for their own retirements.

Managed funds can be “diversified”, with names that suggest how risky they are with names like “defensive”, “conservative”, “balanced”, “growth” and “aggressive”. These funds will invest across asset classes. A financial adviser can match you to a fund by your risk profile, and the period over which you will invest.

Other managed funds are “single sector”. Some fund managers specialise in a type of asset, such as bonds, or equities. Some funds invest in a specific region, or industry. To diversify your investment, you would need to invest in a combination of single sector funds.

With diversified funds, the fund manager determines the asset allocation. With a combination of single sector funds, someone else must determine the asset allocation (such as a financial adviser, or you). Remember that some research suggests that asset allocation is a greater factor in your return than asset selection.

There are many competing companies offering managed funds. A good financial adviser can help you choose a manager that is right for you. They should choose a fund manager according to the robustness of the entity’s investment processes, the quality and experience of their staff, and the total cost of investing in the funds. Remember to ask your financial adviser how they are remunerated, because they may be paid commission for selling managed funds from particularly companies.

DEFINED CONTRIBUTION AND DEFINED BENEFIT

There are two types of pension funds. With “defined contribution schemes” the investor’s money is recorded separately from other investors. When the investor retires, the value accumulated from his or her own contributions, plus returns, less fees, belongs to the investor. These are transparent – you know exactly how much money you have accumulated whenever you view a report from the manager. You retire with a large sum of money. The disadvantage is the challenge of spending that money over your remaining life without running out. This is called “decumulation” and financial advisers are helpful here as well.

With “defined benefit schemes”, the investor’s money is pooled with other investors. Rather than accumulating a lump sum at retirement, the investor earns an income stream from when they reach retirement age until when they die. These funds are much harder to manage over time. When the global financial crisis hit, expected future returns fell, and some defined benefit schemes were identified as “underfunded” (analysts forecast that there wasn’t enough money in the scheme to pay the agreed income

streams to all of their members until they died). Defined benefit schemes are becoming uncommon in many countries.

If you have a defined benefit scheme, be very careful before accepting a recommendation to cash it in. Ask how the adviser will be remunerated if you do cash in or don't cash in (there may be a conflict of interest), and seek alternative opinions. A good defined benefit scheme is a great thing to have, and once cashed in, it cannot be repurchased.

Active and passive investment

Managed funds can be managed actively or passively. Actively managed funds pay professionals to research and choose which assets to buy. Passively managed funds (or "index funds") buy every asset in the sector in proportion to its market size.

Active funds have higher fees. They must pay the professionals for their research, and they often have higher transaction costs as they buy and sell different assets based on their research.

Passive funds can be very cheap. As money is invested or withdrawn, they buy or sell assets to ensure they hold the sector proportionally. Otherwise they simply hold all assets in the market. They do not require professionals to research the market, and they have lower transaction costs.

There is strong debate about which is better, and a great deal of research. Active managers argue that they can generate higher returns than the market can. (The market return is called "beta", and the manager's return above or below the market is called "alpha".) During a "bull market", when markets are increasing, passive funds perform well (and active funds usually do, too). During a "bear market", when markets fall, active managers argue that they can lose less money than passive managers. However, research suggests that it is very rare for an active manager to consistently outperform the market.

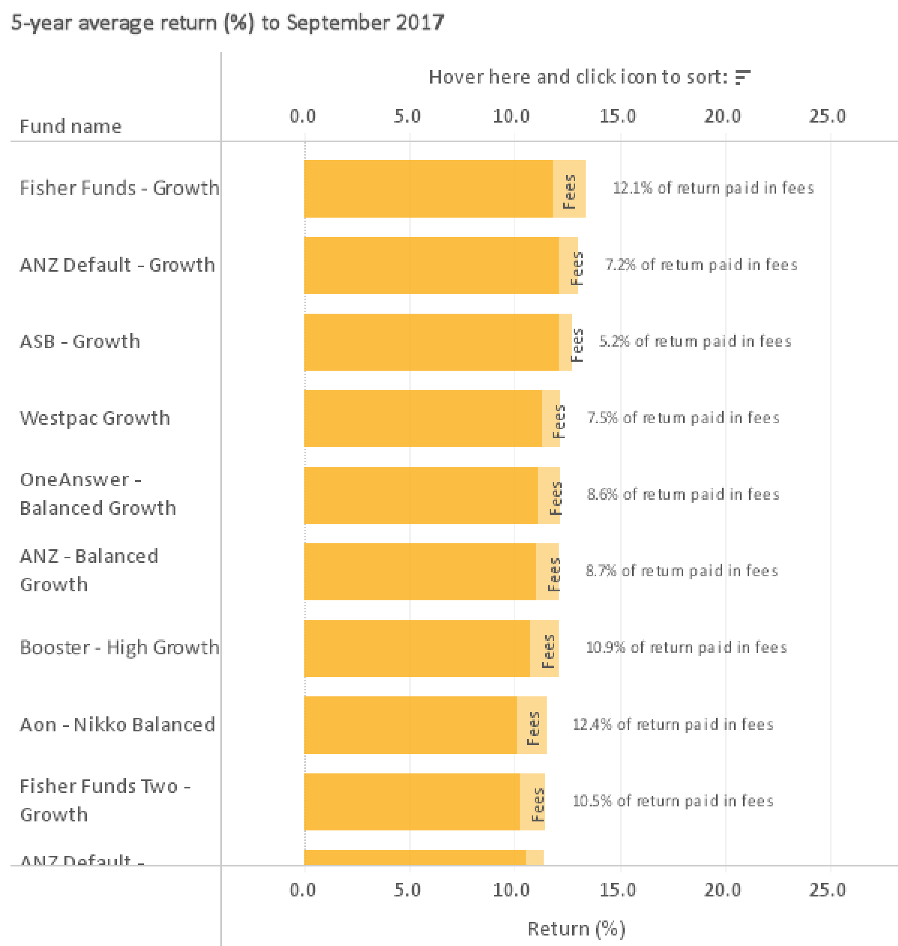
One of the world's most famous passive investors is John ("Jack") Bogle (born 1929), founder of The Vanguard Group. One of the world's most famous active investors is Warren Buffett (born 1930), chairman of Berkshire Hathaway. Famously, Warren Buffett's advice to his heirs is to invest his estate in passive index funds after he is gone.

The impact of fees

Whether the markets rise or fall, fees will reduce the net value of your investment. They are often the only certainty in investing. For this reason, many commentators suggest following a cheap, passive strategy, and paying a financial adviser a fixed advice fee instead of ongoing commission. Remember that net return after fees and tax is the most important number, but future return is uncertain.

Figure 4 illustrates the impact that high fees can have on net return. For example, it shows that before fees, Fisher Funds Growth Fund has a higher return than the ANZ Default Growth Fund, but the latter has lower fees, and a higher net return after fees.

FIGURE 4: FEES CAN HAVE A SIGNIFICANT IMPACT ON NET RETURN



source: https://public.tableau.com/profile/fmaadmin#!/vizhome/FMAKiwiSaverTracker/Story1

Income tax

As outlined on page 14, different countries have different tax regimes. Usually tax regimes are designed to favour investment through the local country. This means that investing directly in foreign markets can result in paying higher tax (as well as being difficult to do).

A good financial adviser can help you identify the most efficient tax structure for your investments. Ensure you ask about fees and remuneration – some structures may earn the financial adviser more money than others, and a financial adviser may recommend the one that earns them the most money, rather than the one that is most efficient for you.

Use your own country's mechanism

All of this complexity means that it would be very inefficient for the International Taekwon-Do Federation to establish a pension fund for its professional instructors.

Most countries have their own pension structures. They often also have great government websites about savings and investment. For example:

- The USA has its 401K regime, and information at https://www.usa.gov/retirement.
- The UK has a robust industry of occupational and individual pension schemes, and information at https://www.pensionwise.gov.uk/en.
- Australia has compulsory superannuation, called "AustralianSuper", and information at https://www.moneysmart.gov.au/.
- New Zealand has an optional regime called "KiwiSaver", and information at https://sorted.org.nz/.

Local pension structures are usually tax- and cost-efficient, and local financial advisers can competently guide you through systems and processes.