Dave Pohl & Associates FINANCIAL INFORMER

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The best money secret ever!

There are many ways to accumulate wealth. Some are slow and others are get-rich-quick. Everything from saving to winning the lotto or being a trust fund kid. However, how you manage your wealth is more about a mindset or a way of living. Get this right (and yes it requires oodles of self discipline) and you will secure your financial independence for a lifetime!

Many times, the biggest obstacle to effective financial planning is the lack of understanding *opportunity cost* and the impact it has on personal finance. In order to take advantage of an opportunity, something else must always be given up.

What is Opportunity Cost?

Opportunity cost is basically what you lose by choosing one opportunity and giving up the next best choice. For a basic example, let's say you can choose between going out for dinner or putting R200 in savings. Each choice has benefits and drawbacks. If you choose the meal, you will likely have a good time, eat good food, and get a chance to relax. If you choose to save the money, you give up that good time and good food, but you get the chance to earn interest on that R200, giving you more money in the future. Either way you stand to gain something and lose something: gain a good time, lose the interest that R200 could have earned. Gain interest on R200, lose that good time. Every time you make a choice, you're weighing the opportunity cost of that action.

The importance of Opportunity Cost

Opportunity cost is even more important when you face big financial decisions. Rent a home or buy one? One comes with the potential to gain value as an investment, but it also comes with added responsibility and expenses. The other will not gain value but will require less time and money over time. Your opportunity cost here is the loss of potential investment gains if you rent versus the loss of time and additional money you incur if you buy.

Go to university or go straight into the workforce? One will be very expensive, but will hopefully yield higher earnings over time. The other choice lets you start earning money immediately, but you may come to a point where your earnings cannot increase without that degree. Your opportunity cost here is the loss of potentially higher earnings if you go to university versus the four years of additional income you will make if you don't go to university. In any situation, which one you choose depends on how much you value the opportunity that you choose versus the one you must give up.

Think about it!

Normally all this goes on unconsciously. You may get out paper and pen and make pro and con lists when faced with big choices like buying a home, starting a business, or going to university, but most of our day to day decisions aren't made with a full appreciation of opportunity cost. We just look at our current account, see that we have money and buy the new shirt or go out to eat. We don't think about the things that we must give up when we make those decisions. In fact, most of us aren't even aware that we are giving anything up. If the money is there, it must be for spending, right? Anything else that that money could do for us seems so far in the future it doesn't register.

Looking ahead

This is where financial problems begin. Sure, sometimes you just really, really want that particular shirt or handbag. And it's okay, within reason, to give in to those desires occasionally. If you're certain that the handbag or shirt is worth more to you than the interest you could earn, the investment you could make, or the other things you could do with that money, then you're making the decision that's right for you. Sometimes the things you want in the here and now are worth more to you than future earnings or purchases. (Although you might not see it that way in ten years, but that's another

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story.) And that's okay. If you only look toward the future, you'll miss out on a lot of things that are fun in life today.

Considering options

The problems begin when you never look at what else you could do with your money. When you buy things blindly or make big life decisions without considering the opportunity cost, you're likely to find yourself making decisions where the opportunity cost doesn't come out in your favour. Let's say you decide to buy a home. You've considered the pros and cons and you decide that the potential upside of buying is worth more to you than any upside that renting could bring. Great. So you start looking at houses. You decide to buy one that's about R500 000 more and several square metres more than you originally planned on. The bank may give you the money, so it's no problem, right? You know that buying is the better choice for you, so you get ready to make the purchase.

Stop. Consider what you're giving up if you choose that bigger, more expensive house. You will be giving up lower utility bills, lower monthly payments, lower insurance costs, lower taxes, and lower maintenance costs. You might be giving up the chance to pay off the bond in ten years versus twenty, which could save you tons in interest and give you the chance to do even more with your money. The bigger house will give you more space and possibly a larger investment return, but are those potential upsides worth more than the other additional costs you will incur? You may decide that indeed they are and go ahead and buy the bigger house. Or you may decide to go with a smaller one. Either way, awareness of the opportunity cost of the choice you must give up will generally yield better financial decisions than making blind assumptions.

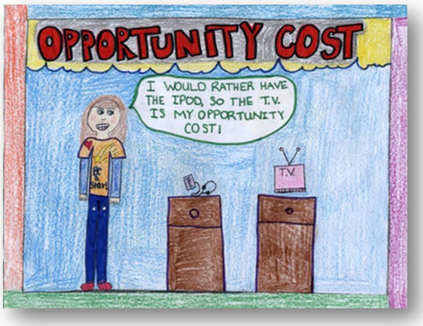
Self discipline goes a long way

It sounds like a drag to think about opportunity cost every time you want to buy a chocolate bar or some shoes, doesn't it? But that's exactly what you have to do in order to make the best use of your money. You cannot go through your financial life on auto pilot, assuming that the choices you make today don't have costs in the future. You have to understand that when you purchase one thing, you are giving up other choices that might have been better. While you can't know everything that will happen in the future, you can have a good general idea of the impact your choices will have.

The good news

It only gets easier! Once you practice being conscious of the opportunity costs for awhile, it becomes easier and more subconscious. You don't have to actively think about the trade-offs of your choices as much. You will eventually be able to make decisions that take those costs into account without it being a big production. And that's when your financial life will start to take off.

Make the right money choices, select your "opportunities" carefully, and you will not only control your wealth but grow it.



Keep in mind that opportunity cost is a function of time. Holding on to an underperforming investment for months or even years can lead to much higher opportunity costs, as can the decision to lock in to a low return over a long period of time.

Opportunity cost in investing should be viewed through the lens of your personal financial situation. Would you be better off paying down debt? If an investor earns a 6% yield on an investment but is paying out 18% annually in credit card interest, that person is in fact losing money, not earning it.

From caves to computers - 10 financial innovations

It is thought that basic trade - the simple exchange of goods - existed from the time that earliest humans first learned to communicate with one another. Trading then would likely have consisted of the bartering of tools, food, skins and basic commodities between neighbouring family units. This is a far cry from today's internet based banking and sophisticated investment and credit products. This article looks at ten financial innovations which changed the world.

In the beginning - commerce

Our ancestors would have bartered basic commodities from prehistoric times, but commerce as we know it today – the exchange of goods and services over long distances - is clearly a more recent development. However, historian Peter Watson dates the existence of long-distance commerce to as far back as 150,000 years ago. There is evidence that some of the earliest traded commodities were flint

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A cruel twist

Planning for the accrual system in a Will

The Accrual System, introduced into our marriage law in 1984, automatically applies to all marriages out of community of property, unless specifically excluded by the relevant antenuptial contract.

In terms of the Accrual System, during the marriage the spouses are fully independent and there is a complete separation of property. On dissolution of the marriage either by death or divorce, the gains made during the marriage are shared. The Accrual System is intended to ensure that spouses share equally in the wealth they accumulate during the marriage.

On the death of a spouse, the Accrual claim is calculated and depending on their respective gains, could result in either (i) a claim being lodged by the surviving spouse against the estate of the deceased spouse (if the survivor shows the smaller gain) or

alternatively, (ii) the survivor might be required to make payment into the deceased spouse's estate (if the latter shows the smaller gain).

The rule is that the Accrual claim is calculated and takes effect before applying the deceased

spouse's Will. The Accrual claim, if it is due to the surviving spouse, constitutes a claim against the deceased estate which ranks in preference ahead of heirs. In other words, the Accrual claim due to a surviving spouse must be calculated before the terms of the Will are applied.

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and obsidian, substances used to make primitive tools.

Greasing the wheels - money

While the original form of trade would have been barter - the direct exchange of goods - the invention of money greatly simplified and promoted trade.

The first objects used as money were commonly available objects which, besides having an intrinsic value, were also acceptable to people as a medium of exchange for other goods and services. This type of money is called "commodity money" and examples from history are numerous, including cattle, pigs, salt, rice and seeds. In medieval Iraq, bread was used as an early form of money while the Aztecs used cocoa beans as money.

Coining it – metal coins

Ultimately, everyday commodities, such as cattle, are inconvenient as a store of value for commercial trades due to their inconsistent quality, their indivisibility and because they are easily perishable. As soon as mankind discovered metal, this was used to make utensils and weapons previously made of stone. Due to metal's relative advantages, such as the ability to easily calculate its value, its divisibility, and its ease of transportation and beauty, it became the main standard of value and medium of exchange.

Originally, metal was used in its natural state as a medium of exchange but later it was fashioned into practical shapes, called coins, each having definite form and weight, and receiving marks indicating value. This development made transactions faster and easier.

The first coins seem to have been manufactured separately in India, China, and around the Aegean Sea (situated between Greece and Turkey) between 700 and 500 BC. Probably, the first historic character to have his effigy appear in a coin was Alexander the Great around the year 330 B.C.

Pressing on – paper money

Development of the banknote began in China during the 7th century AD. Before the use of paper, the Chinese used coins that were circular, with a rectangular hole in the middle. Several coins could be strung together on a rope. Merchants in China, if they became rich enough, found that their strings of coins were too heavy to carry around easily. To solve this problem, coins were often left with a trustworthy person, and the merchant was given a slip of paper recording how much money he had with that person. If he showed the paper to that person he could regain his money.

In the 13th century, Chinese paper money became known in Europe through the accounts of travelers, such as Marco Polo. Polo's account of paper money during the Yuan Dynasty is the subject of a chapter of his book, *The Travels of Marco Polo*, titled "How the Great Kaan Causeth the Bark of Trees, Made Into Something Like Paper, to Pass for Money All Over his Country."

The use of banknotes issued by private banks as legal tender has gradually been replaced by the issuance of banknotes controlled by national governments. Until recently, government-authorised currencies were forms of representative money, since they were partially backed by gold or silver and were theoretically convertible into gold or silver.

A risky business - insurance

Insurance is one of the oldest financial innovations, predating paper money (and even coinage) by some margin. The first methods of redistributing risk are thought to have been practiced by Chinese traders as long ago as the 3rd millennia BC, who when travelling treacherous river rapids would redistribute their wares across many vessels to limit the loss due to any single vessel's capsizing.

The first recorded written insurance policy dates back to about 2000 BC, with evidence found that the Babylonians developed a system whereby if a merchant received a loan to fund his shipment, he would pay the lender an additional sum in exchange for the lender's guarantee to cancel the loan should the shipment be stolen.

Bank on it - banking

The history of banking is said to have begun around 2000 BC in Assyria and Babylonia, when merchants made grain loans to farmers and traders who carried goods between cities.

Banking, in the modern sense of the word, can be traced to the rich cities of Florence, Venice and Genoa in medieval and early Renaissance Italy. The word *bank* was borrowed from the Italian *banca* meaning "bench" or "counter". This is because benches were used as desks or exchange counters by Florentine bankers.

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Share and share alike – companies and stock exchanges

Size tends to count in business; in modern times, companies dominate economic life in the global economy. However, entities which carried on business and were the subject of legal rights were found in ancient Rome and in ancient India. The innovation of joint ownership made a great deal of Europe's economic growth possible following the Middle Ages. The technique of pooling capital to finance the building of ships, for example, made the Netherlands a maritime superpower.

The development of stock exchanges - markets where shares are traded - gave companies access to finance from vast numbers of investors. Unofficial share markets existed across Europe through the 1600s, where brokers would meet in or outside coffee houses to make trades. The Amsterdam Stock Exchange, created in 1602, became the first official stock exchange when it began trading shares of the Dutch East India Company.

The plastic revolution - credit cards

The concept of a card, and more particularly a plastic one, functioning as money is relatively new in the history of money. The idea of issuing a card which could be used to purchase goods on credit from a multiple of vendors is said to have been thought out when a forgetful New York banker, having forgotten to bring cash with him, found himself unable to pay for his meal at a restaurant.

At the end of the meal, Frank McNamara discovered that he had forgotten his wallet (ironically, in the words of a future competitor, he had “left home without it”) and he had to call his wife to bring him some cash. The story goes that McNamara came up with a new idea - a credit card that could be used at multiple locations. McNamara and his dining companions decided to form a new company – the Diners Club. The innovative part of the new concept was that the Diners Club would be a middleman between the vendor companies and their customers. Instead of individual companies offering credit to their own customers, the Diners Club was going to offer credit to individuals for many companies (and then bill the customers and pay the companies).

Automatic for the people – the Automatic Teller Machine

By the mid-20th century the scale of banking had progressed to the extent that most economically active adults had a banking account. The idea of self-service in retail banking developed through independent and simultaneous efforts in Japan, Sweden, the United Kingdom and the United States.

Luther Simjian has generally been credited with developing the first automatic teller machine. His machine (which didn't dispense cash) was first installed in 1960 in New York's First National City Bank (now CitiBank). It allowed customers to pay utility bills and get a receipt without a teller. In 1967 a Barclays Bank branch in North London introduced the first cash dispenser; it used paper vouchers bought from tellers in advance.

Today, estimates place the number of ATM’s in use worldwide at over 2.2 million: approximately 1 ATM per 3000 people in the world. ATM’s are found on every continent including Antarctica, which has one on its McMurdo Station.

Commerce in the Information Age - online banking

Today, internet banking is an enormously popular form of retail banking. Surprisingly though, the first form of computer based retail banking was offered as far back as in 1981 by four of New York’s major banks (Citibank, Chase Manhattan, and two others) using the “videotex” system. If a customer had a terminal, monitor and a phone line he could access the banking system, by using a numeric keypad to send messages down the phone line to his bank. However, these banking services never became popular (except in France and the UK).

Stanford Federal Credit Union was the first financial institution to offer modern online internet banking services to all of its members in October 1994. The popularity of internet banking has since grown exponentially to the extent that in some countries banks exist which offer only online services.

Over time, mankind has progressed from the basic bartering of stone and food to being able to transferring intangible wealth by tapping on a keyboard. Who knows what the future will bring from here and what innovations await us?

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For example, if a testator, married to his wife with the Accrual System, has an estate worth R3m net (before factoring in his liability for an accrual claim) and he intends to have his wife and a child from a previous marriage each receive R1.5m, he may (in the absence of prudent advice) be inclined to simply state in his Will, “I leave my estate in equal shares to my wife and my child”.

However, the actual result, regardless of his intention, will be as follows (assume his wife’s accrual claim is calculated at R1m):

*His wife will receive R1m (her accrual claim) PLUS half of balance of the estate after the accrual claim is paid i.e. ½ x (R3m – R1m) = **R2m in total***

*His child will receive half of balance left in the estate after paying the R1m accrual claim i.e. ½ x (R3m – R1m) = **R1m in total***

As the testator overlooked his obligation to pay the accrual claim, the resultant split is not that which the testator intended when he stipulated they should “share equally”.

By properly planning for one’s death, one can ensure that the effect of an accrual claim is properly dealt with. This planning may include life assurance which can be useful to ensure that there is enough cash in an estate to pay an Accrual claim or to provide direct cash payments to spouses and other family members.