M&G **Insights**

Darius van der Walt
Head of Product Development

Three tips for teaching young adults how to handle income

Learning how to handle income is an important part of becoming an adult. In a tribute to Youth Month this June, we've explored a few ways to steer youngsters in the right direction.

Earning your very first salary, whether it's from a full or a part-time job, is an important milestone in a young person's life, and can be quite exhilarating. Suddenly you have more money to hand than ever before and everything you've ever wanted is potentially within your reach -- particularly if you're still staying at home and don't have to pay for things like food and rent.
This is the mindset that parents face when their children start earning. And it's a mindset they need to moderate if they want their kids to build a financially healthy future.

Save from the start
Your youngsters might officially be adults – free to sign contracts and conduct their own affairs – but they're inexperienced. As difficult as it can

be to rein in an older child who's earning his or her own money, it's necessary, since what they do with that money over the first five to 10 years of working can be vital to their long term financial well-being. And once those years are gone, you never get them back.

Perhaps trying a little shock tactic is a good place to start. Ask them how much money they think it takes to retire in reasonable comfort. They probably have no idea, but get them to have a look at our easy-to-use Retirement Calculator, where you can adjust timeframes and amounts to see how much savings they might need. A common rule of thumb for retirement planning calls for approximately eight times their projected final salary. So, if they're earning R3 million a year by the time they're 65, (which, taking inflation into account, is not inconceivable) they'll need a retirement nest egg of R24 million. This is a staggering figure, but one that, thanks to the power of investing and compound growth, can be achieved by starting young, preferably from their first paycheck.

It's not about simply saving eight times your projected final salary, in this case R24 million -- that would be quite a daunting task. Rather, it's about investing consistently over time as your salary increases, and allowing for compounding, which means that you stay invested and allow growth on your previous gains to occur. It takes about 40-45 years to achieve a comfortable retirement, especially as we're living longer than ever before. Here's a current example of compounding: Say your youngster invested R500 a month into a South African Balanced unit trust fund. The table below shows the amount he would have contributed over various periods, the returns achieved, the growth this translated into, and the total value per period.

After 20 years, he will have contributed R120,000. But his capital will have grown to R337,380. This is the power of investing and compounding, and it should act as an incentive to save from day one.

Years	Contributions	Annualised return	Growth earned	Total value
1 Year	6 000	7,7%	137	6 137
3 Years	18 000	8,9%	3 008	21 008
5 Years	30 000	6,6%	6 869	36 869
10 Years	60 000	8,5%	26 722	86 722
15 Years	90 000	7,5%	79 878	169 878
20 Years	120 000	10,5%	217 380	337 380

Avoid 'bad' debt

In addition to investing from their first paycheck, your working children need to understand the perils of racking up too much debt, and the difference between 'good' and 'bad' debt. Companies have long encouraged consumers to 'buy now and pay later'. While it sounds easy enough, few young people really understand the impact on their finances. Let's say your offspring 'purchases' some top designer shoes on credit for R4,200 and pays them off over five years. In the end it could cost him double that amount. Does your child really want to pay so much? Is it that important? Going into debt for luxury items at high interest rates is a costly exercise and rarely worth it.

Now the same could be said for cars, but without a decent public transport system, having a car is essential in South Africa. But does she really need a brand-new car? Won't a decent second-hand car do just as well? After all, whether new or second hand, cars depreciate the minute they're driven off the showroom floor. Spending less each month on car payments will allow your child to invest the difference.

While it's true that people talk about 'good' debt and 'bad' debt, there is really only one form of 'good' debt. That is, debt that pays for an asset that can actually gain value over time, such as a house or other form of property. Most debt pays for depreciating assets, and that's where you really want to be careful.

Risk and return

There are many financial concepts and terms for young adults to learn, but the concepts of risk and return are among the most important. Put simply, there is always a positive relationship between the potential return on an investment, and the level of risk taken to achieve that return. In terms of traditional investments, bank accounts typically offer the lowest returns and the lowest risk, while equities offer the highest returns, at the highest level of risk.

At least that was the case until the arrival of cryptocurrencies. Starry-eyed about the potential for high returns, young adults today are strongly drawn to digital, or 'crypto' currencies such as Bitcoin and Ethereum (in fact, as at 15 June this year, there were 9,905 cryptocurrencies, according to Coinlore). Yet these currencies also come with very high levels of risk, and although potentially useful as a payment mechanism, as a successful long-term investment, the jury is decidedly still out.

Giving guidance to our children never really stops – it just becomes more complex. But when it comes to something as important as building a solid financial future, it's worth the effort! As a starting point, you might want to take them through our Guide to Investing in Unit Trusts.

For more information on investing with M&G Investments, please feel free to contact our Client Services Team on 0860 105 775 or email us at info@mandg.co.za.

https://www.mandg.co.za/insights/articlesreleases/three-tips-for-teaching-young-adults-how-to-handle-income/