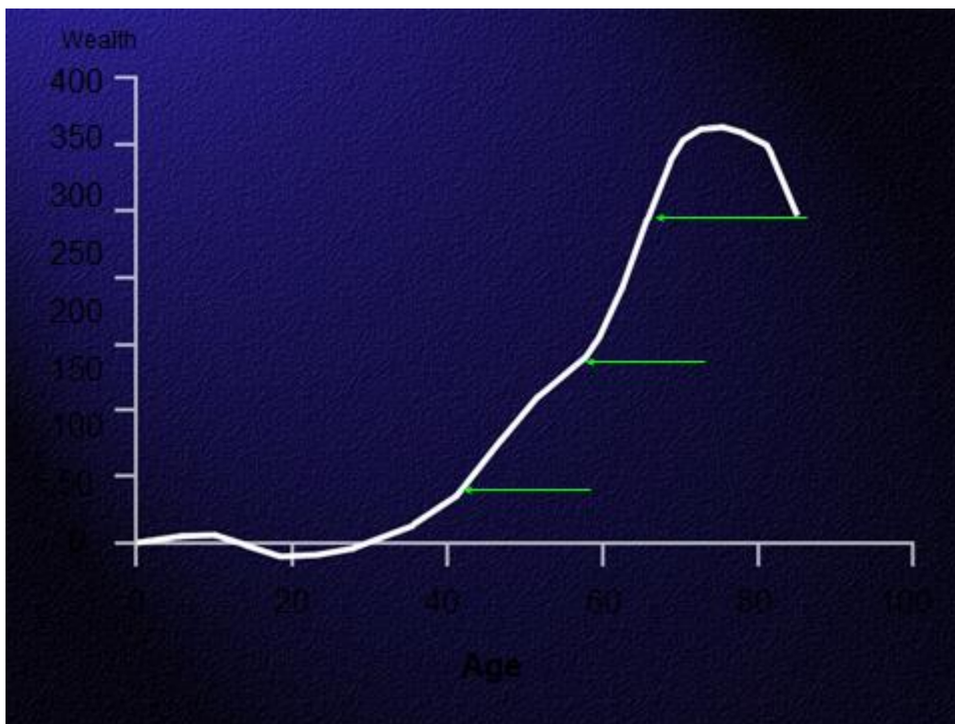
Investing for Farmers
Broadening Wealth and Growing Skills

The only reasonable way to measure wealth is to look at your net worth – i.e. what you own less what you owe. If you add up everything that you own and deduct what you owe, you have the figure for your net worth.

Wealth is not measured by income, it is measured by net assets – there are plenty of people who look wealthy (nice house, nice car, nice overseas holidays etc.) but these people are often not wealthy at all: they have a good income but there is little wealth behind them.

The graph of a typical person's net worth through life looks like this:



By almost any standard that you might use, most SMASH farmers are wealthy – the average net worth is about $3m. In this respect, you should appreciate what you have and congratulate yourself for how well you have done, while remembering that the vast majority of people in this country would swap finances with you in a flash.

You job is to get ready for 20 Good Summers – while having the most satisfying life as you can on the way through. This means building your net worth so that you can invest for enough passive income to have the time of your life (a.k.a. retirement).

How much is enough?

This can be a difficult calculation as it is made up of a matrix of six factors:

1. The cost of your lifestyle.
2. The lifestyle assets that you want (house, boat, etc).

3. Size of estate that you want to leave.
4. Other income (e.g. NZ Super).
5. Work that you might do.
6. Investment returns.

Many SMASH farmers may already have enough to retire on. For example, a farmer has a net worth of $3m. They sell the farm and cash up.

The couple buys a house, a boat and take a trip to Europe on the sale of the farm – total cost **$800,000**.

They now have **$2.2m** to invest. They get an investment return of 3.5% after fees, tax and an allowance for inflation. (The allowance for inflation means that they are growing the portfolio by the amount of inflation so that they maintain both their capital and their incomes in real terms).

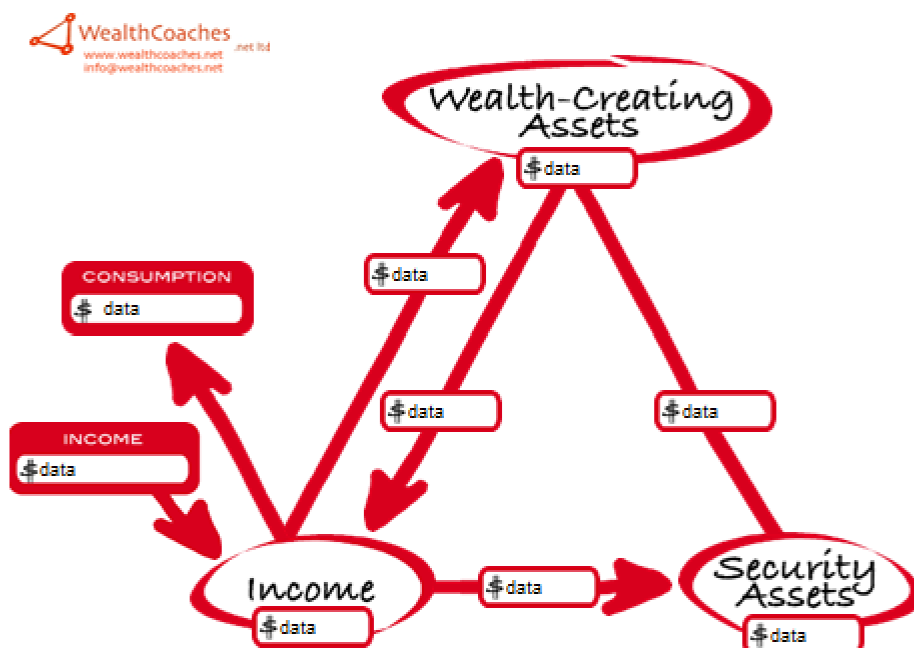
$2.2m @ investment return 3.5% = **$77,000** **per annum**

In addition to the investment income of $77,000 p.a. they may have NZ Super (approx. $15,000 each person from age 65 years) and, perhaps, income from any work that they do. This $77,000 p.a. will grow with inflation.

Planning

If you can fill in the numbers on the model below, it shows two things:

1. Where you have your capital (most farmers have everything in the farm – i.e. everything in Wealth Creating Assets).
2. How your cash flows (after consumption, most farmers put all of their income back into the farm).



Farmer should divert a part of their income so that they invest in **Security Assets** (a.k.a. off-farm investments). These will not give returns as great as farming but there are some good reasons for having Security Assets:

1. Farming is risky (variable commodity prices, exchange rate risk, bio security threats, climate and all the other business risk). It pays, therefore to broaden your financial base.
2. Security Assets are safer – more diversification (by industry and geography).
3. The off-farm investments act as reserves to get you through tough times.
4. You can use the reserves to profit from downturns.
5. Lets you get money offshore.
6. Other investment beyond farming can be profitable.
7. Even relatively small amounts going to Security Assets give you experience and new skills.
8. They help with succession.

While many farmers have all of their wealth tied up in a farm, it is far better to plan to use farm profits so that you make some off-farm investments.

Investing for profit

The investment process is about three things:

1. Investor type/asset allocation

The first thing that you as an investor should do is to find out what type of investor you are. You can find out what type of investor you are (i.e. what returns that could get and what risk you are taking) by going to https://www.sorted.org.nz/calculators/investment-planner.

The type of investor that you are establishes your investment asset allocation (i.e. the amount that you have in each of the main asset classes). Research shows that the most important determinant of your investment performance is asset allocation – the returns that you will get and volatility that you will experience is driven by asset allocation more than anything else. If you do not get this right at the beginning, your investment experience is likely to be an unhappy one. Too much in shares and property may mean that you have more volatility than you can handle; too much in bonds and cash will mean that you have poor returns and may not meet your goals.

There are five investor –type categories:

Defensive	20% shares and property, 80% bonds and cash
Conservative	30% shares and property, 70% bonds and cash
Balanced	50% shares and property, 50% bonds and cash
Growth	70% shares and property, 30% bonds and cash
Aggressive	80% shares and property, 20% bonds and cash

Things to think about with asset allocation and investor type:

- Investor type is judged on three main things: your financial capacity, the time you are investing for and your psychological ability to handle volatility.
- In good times, most people think they are more aggressive than they should be, but in tough times they run from risky assets. This is the opposite of what they should do – always remember: buy in gloom, sell in boom.
- About 40% of your investments should be in International investments – you need to get money outside Australasia (New Zealand in particular has a small and brittle economy which could be hard hit by another big earthquake, bio-security breach etc.).

2. Investment selection

This is the selection of the individual investments that you will make. Whether you decide to use managed funds or make direct investments, you need to be sure that you are well diversified within the asset class (i.e. own a range of shares or a range of bonds etc.)

Investment selection is usually improved by the help of an investment adviser or share broker.

People often get very concerned about investment selection. However, it pays to remember that selecting the best investments is not as important as having the right asset allocation.

Things to think about with investment selection:

- The best investments are those which have the most income compared to the price that you are paying (although you also have to judge whether the income is sustainable and/or likely to grow).
- Managed funds give you quick and easy diversification in particular asset classes.
- Commercial property and offshore investments are often best made by managed funds: it is very difficult to buy the best quality property directly (very expensive) and the Listed Property Trusts (LPTs) are a better alternative to buying a smallish building yourself.

3. Management and monitoring

Keeping an eye on your investments is necessary. Most important is that you watch your investments to make sure that you stay reasonably in line with the asset allocation that you should have: as some asset classes rise and others fall, you asset allocation can become distorted. For example, you may be supposed to have 30% of the portfolio in shares but a good share market performance may result in you having 40% in shares. At times, you need to rebalance, selling some shares to bring you closer to the 30% that you are supposed to have and putting the proceeds from the sale to an underperforming asset classes. This may sound like a strange thing to do (selling the market that is performing to buy the one that is doing badly). However, that is exactly what astute investors do – they buy in gloom and sell in boom.

You also have to watch your individual investments. While many investors buy their investments with the intention of holding them for years, the prospects of companies and trusts change and there are times when you have to sell non-performers.

Things to think about with investment management and monitoring:

- There may be times when you tactically asset allocate – i.e. you buy more of a particular asset class because you think its future prospects are very favourable or own less of another asset. You should only do this with a lot of thought.
- A good example of tactical asset allocation currently is international bonds – yields from these are very, very low at the moment and many investors are simply not buying them.
- Another example is residential property where the yields are also low and government is trying hard to curb price increases – in my view, this is not a good time to buy rental property.

Moving some of your wealth to off-farm investments makes a lot of sense. Off-farm investment gives you more security and the investment skills that you learn can be used for the rest of your life. This learning will help not just future investment but what you learn about other businesses can be applied to your own farming business.

Start investing slowly with small amounts of money. Be cautious – make only small mistakes (if any!) and treat them as learning experiences. As well as making money, investing can (and should be) a lot of fun; however the most fun comes when you are making money, not losing it.