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RICH MAN POOR MAN!

A couple of years ago a friend of mine came across a book called "Tricks of the Rich" by Paul Overy. This book describes a number of common sense ways to improve your chances of getting rich. I didn't buy the book myself but my friend outlined the basic ideas to me and I then had a chance to listen to the author at a property seminar in Citywest Hotel. Part of the book was even serialised in the Sunday Business Post.

I would describe my friend as a relatively risk averse person and he would not have been the type of person to take on much debt but having read the book his attitude changed. He seemed convinced that borrowing was the way to get rich as long as he bought a good asset with the borrowings. He seemed to think that I was too conservative because of my stated desire to keep borrowings to relatively modest levels. I outlined my fears of borrowing along the lines that I would need a lot of confidence in the asset I was buying to believe that it would generate returns higher than my borrowing costs.

In relation to shares I said that I would not borrow to buy any even if I could find someone to lend me the money in the first place.

With regard to property I said that I would only borrow to buy investment property if I knew I had a quality tenant locked in on a long lease and the net rental yield is higher than the borrowing cost. At the time this effectively ruled out buying in Ireland and the UK!

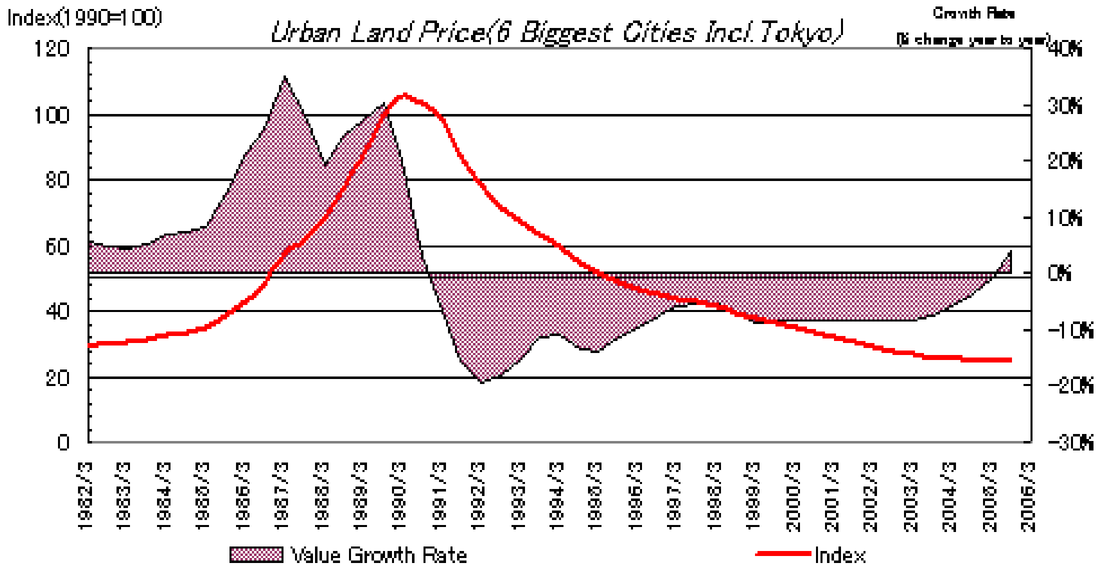
As I mentioned above I did not buy the book but in the Sunday Business Post archives I found the following quote from his follow on book "Tactics of the Rich":

> However, remember that true wealth creation happens over the long term. I find it impossible to contemplate an environment where property bought today would be generally less valuable in, say, ten, 15 or 20 years.
>
> This is not to say that I cannot imagine such an environment, but it would require a catastrophic economic event or a series of such catastrophic events. While that is possible, it is improbable in my opinion.

Having been involved in the Japanese market since 1987 I would argue that you do not need to have a catastrophe to lose money in a property market. Japan has muddled along for 18 years avoiding catastrophe and yet anyone that bought property in the bubble has seen major losses and anyone that borrowed to buy that property is likely to be a hell of a lot poorer rather than richer! (see chart below)

My experience in the Japanese market makes me question the assumptions that are at the core of "Tricks of the Rich". I think it is too simplistic to say that property will be worth more if you hold on to it for 20 years. I think that you have to take into account valuation. It is quite feasible that if you buy at a time of low rental yields, even in a relatively stable economy you could lose money if those yields rise.

Japanese Land Prices (1982-2006)
(This chart does not show that land prices in 2008 started to fall again)



Reading about Iceland makes me wonder whether they bought "Tricks of the Rich" and convinced themselves that they should buy assets like House of Fraser, Hamleys toy stores and Merrion Stockbrokers with money borrowed internationally! (They even lent the money to other investors like Robert Tchenguiz to buy his 10% stake in Sainsbury)
They have now seen just how risky that approach can be.
In the long run investments like Sainsbury might have worked out well but when you use borrowed money you might not stay solvent for long enough to see that come to fruition.
Once again I turn to Warren Buffett for inspiration in this regard. He does not borrow with Berkshire Hathaway and in his opinion you should generally buy assets with savings. (I think that he would acknowledge that insurance premiums are a form of borrowing buy he manages to do it for no cost most of the time................ now that is the type of borrowing that makes sense to me!)
None of the shares I own have been bought with borrowed money. I have put my savings to work and I hope that I can hold on to them long enough to generate a return greater than the risk free rate. Given that my portfolio was down about 38% year to date as of Oct. 27th I may have to wait quite some time before I generate such a return but in the mean time I hope to use this fall as an opportunity to buy a bargain or two.

Finally to be fair to my friend I have to acknowledge that he has been cautious in terms of the assets he bought with borrowed money. He did not buy property in Ireland or the UK and the only other thing he bought was a structured financial product with a capital guarantee. (All he can lose on that one is the interest cost but I have a hunch that that is exactly what will happen)

The cynic within me makes me wonder whether one of the “Tricks of the Rich” not mentioned in the book is to write a book about how to get rich! ....