STEP BY STEP WITH MONEY

By Stephen Diedericks BCom, CPA, Juris Doctor (Masters of Law)

We continue our series on '**Saving Money**'. Last week I ended by putting the proposition that we should create a security blanket with our cash savings. This week (16) I will compare cash savings with hedging. This is important because when we save our cash we want it to retain its value over time, rather than loose value.
Please note, I am not providing any financial advice and you should seek financial advice for your specific circumstances.

You may have heard that $1.00 today is worth less tomorrow. This is caused by inflation. Inflation is the increase in the price of goods and services in New Zealand. Inflation decreases the money saved in banks. To combat this bank's pay interest on the money deposited as savings. However, the interest paid should be greater than the rate of inflation. If not, then the value of our savings deposited will decrease.
Let's explain this in an example. We save $1,000 with a bank. The bank pays us interest at 4% p.a., i.e., $40 after 12 months. The inflation rate over that 12-month period is 3%. This has the effect of reducing our $1,000 savings by $30, which means after 12 months our $1,000 savings is worth $970. However, the bank pays us $40 interest. Therefore, our $970 is now worth $1,010.

Not quite. We have to pay income tax on our $40 interest. The tax rate could be as high as 33%. Tax on $40 x 33% = $13.20. The net amount from our interest is $26.80 [$40 (interest) - $13.20 (tax)]. After 12 months' the value of our $1,000 savings after inflation and taxes is $996.80 [$1,000 (savings) + $40 (interest earned) - $30 (inflation) - $13.20 (tax on interest). The value of our savings is $996.80, not $1,000.

This is an extremely simple but effective way of showing how inflation and taxes can reduce our savings. Knowing this we can look for ways to increase our savings. We could find higher interest rates. Another alternative is to hedge our cash savings.

A final word on inflation. Inflation results from the value of our money decreasing. The value of our money decreases because the price of essential products such as food, fuel and services increase while our income remains constant. Inflation most impacts people described as 'poor', savers (as shown above) and elderly people on fixed incomes.

A hedge in simple terms is to protect yourself against something unpleasant happening.

A good way to hedge against cash and inflation is buy holdings gold and/or silver. They are known as commodities. **As noted above, I am not advising you to buy gold and/or silver, I am saying that they are good ways to hedge against a decrease in cash. If you recall, last week I mentioned that items increase and decrease in value then those same items again increase and decrease. Your financial education will determine if this is good for you.**

The reason gold and/or silver are good commodities to hedge against cash and inflation is because they are purchased with cash today. When inflation increases or the government puts more cash into public hands by printing money and/or reducing interest rates, inflation increases and it causes the value of gold and/or silver to increase.

Cash is generally stored in a bank or in accounts via the internet. Unless we are physically holding cash, we do not need any significant storage space. This is not the case with gold and/or silver. They need to be stored with proper security. This adds to the cost of holding gold and/or silver.
Next week I will describe a profit and loss statement and a balance sheet. As we continue to grow our Network Marketing business and earn income and save money we should be aware of how this fits into our financial statements so that we can read our statements.