FINWEEK (English)
20 Mar 2015, p.43

MONEY 101:
Handling an unexpected windfall

BY KRISTIA VAN HEERDEN

We are often paralysed by the idea of investing, but becoming a successful investor starts long before you make your first investment. In this series of articles, Finweek draws up a road map to get you from financially flustered to investing with confidence. So far, we've helped you make sense of your payslip, discussed ways to supplement your income and had a look at your credit score. Visit Finweek.com to view all articles in this series.

Gerald Mwandiambira

From time to time a happy coincidence befalls us and we receive an unexpected cash injection. This is reason to rejoice, to be sure, but sadly not reason enough to indulge.

A windfall is any amount of money received unexpectedly, like a tax rebate, an unhoped for but well-deserved bonus, a prize or a gift. Sadly, windfalls don't come around often, but planning for potential good fortune should form part of a well-thought-out long-term financial strategy.

Should good fortune befall you today and you don't yet have a plan, certified financial planner Gerald Mwandiambira advises that you park the money in a notice deposit or money market account while you weigh your options. You are more likely to overspend if the money stays in your day-to-day account.

Once the money is safely out of your reach, Ilse Smuts of FNB Savings and Investments says that personal preference, risk appetite, minimum-balance requirements and financial needs all affect savings and investment

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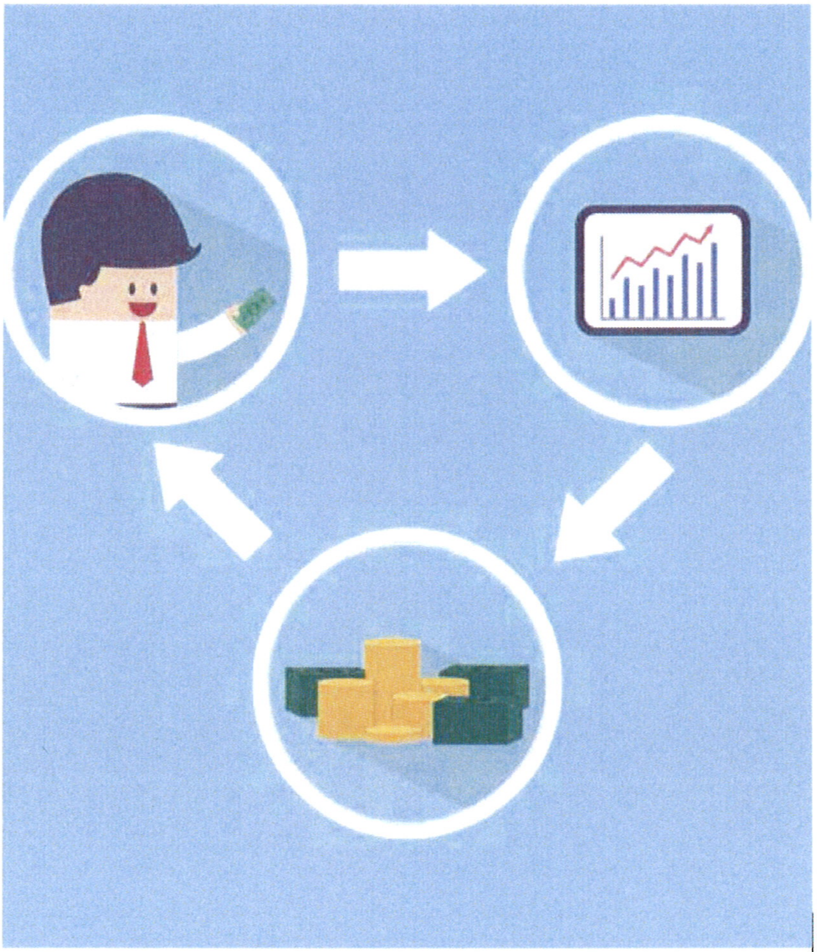

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decisions. Below is a five-step plan to use as a starting point when deciding how to spend your windfall.

STEP ONE: STAY OUT OF JAIL

Before you spend a cent of your windfall, Mwandiambira advises you consider the tax implications. "The most obvious cost of receiving a large amount of cash may be the tax implications of your sudden riches. Before going on your spending spree, consider if the money is taxable as income and make provision for this by setting aside tax," he says.

If you're not sure what the tax implications are, consult a tax professional. It is a lot cheaper to pay an expert upfront than it would be to find the tax you owe at the end of the year.

STEP TWO: DEFEAT DEBT

Many South Africans struggle to find money in already constrained budgets to pay back debt. If you are indebted, putting your windfall towards paying off your debt should be your first priority.

Says Sonia du Plessis, CFP at Brenthurst Wealth Management: "Start by paying off the debt that has the highest interest rate. If [you have] no short-term debt such as shop cards, credit cards or paying off a vehicle, paying an additional amount into a property bond can reduce the total amount paid for the property significantly and deliver a good return on the money, considering the total interest to be paid over the term of the loan."

STEP THREE: EMERGENCY EXIT

"If you are fortunate enough not to carry debt, beef up your emergency fund," Mwandiambira recommends.

Emergency funds are cash reserves to help you through difficult financial periods or to cover unexpected expenses.

STEP FOUR: SAVE OR INVEST

"You can use a portion of the money received to inject a lump sum into one of your existing accounts or you can spread it over your various accounts in order to give your balances a boost and reap rewards that are aligned to your savings and investment goals," Smuts says. The investment options you pursue depend largely on your unique financial situation, according to Du Plessis. She recommends considering the following three factors:

1. Your age, as it will determine the investment time horizon.
2. Your risk profile, which determines what type of investment is best suited to your needs.
3. Your personal situation. "The investment decision will be different for married, divorced, single, young, mid-career or retired people. Each situation demands a different approach to investment and savings."

STEP FIVE: TREAT YOURSELF

Depending on the size of your windfall, you might not be able to pay off your debt, bulk up your emergency fund and invest all

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in one go, but taking those steps, however small, will get you ever closer to wealth. "Spend a little cash on a simple pleasure like a domestic holiday or an affordable trip to relax and cool off," recommends Mwandiambira. He warns that windfalls should never result in a lifestyle change and extravagant spending should be kept to a minimum.

BONUS STEP: ASK FOR ADVICE

It is not unusual to consult a medical professional when you get ill and the same should hold true for your finances. If you are unsure of how to get to the next level in your financial life, don't hesitate to contact a professional.

It is always advisable to consult a financial adviser to review your personal situation, the size of the investment and risk profile to select the most appropriate investment from the vast range of local and global funds and investment options. ■

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HOW TO INVEST A WINDFALL

MANY PEOPLE REGARD THEIR additional income as money that falls outside of their traditional income, and can be spent freely. But, says Jacques van Heerden, head: retail bank, transactional and investments at Standard Bank, investing your bonus wisely not only reduces stress, but it can pay handsome dividends if used to pay off your debt.

BELOW ARE A FEW EXAMPLES OF HOW TO MAXIMISE YOUR WINDFALLS:

■ Settle retail accounts. Accounts are a major drain on personal finances. Buying a new outfit or jewellery may bring joy, but having to pay for it every month can soon take the shine off the bling.

■ Investing to beat inflation. You could consider investing your windfall to grow your wealth, or you could consider putting it into a long-term investment portfolio, such as a unit trust, which is an ideal way to grow your money and build wealth.

For example, if you buy a unit trust worth R10 000 and earn a 9% annual return over three years, you will have grown your money by R2 950. By investing the original R10 000 for five years, you will earn R5 386. And if you continue to hold your investment for 10 years, without adding a cent, you would earn interest of R13 674.

Invest in a retirement plan if you don't already have one. It will give you peace of mind knowing that you can retire comfortably in the future. If you get an annual increase along with your extra income, use the increase to add to this investment every month.

You may think that saving about R500 a month may not be worth it, but if you invest R500 a month for five years at a return of 9% and an escalation of 5% per annum, you will have saved R41 200. In addition, your R10 000 will have grown to R15 386.

■ Investing in your education. Whatever industry or service you're in, changes and developments are happening at a significant speed; if you don't continually educate yourself, you may be left behind. Don't wait for your employer to offer training, go out and do it on your own account and reap the financial rewards that come with it.

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