It's never too early to start investing

Starting your children at an early age gives them more time to compound their wealth

By : Royston Yang

The power of compounding over decades can grow a small investment into a sizeable amount. PHOTO: PIXABAY

CHINESE New Year has arrived once again, and this annual celebration never fails to remind me of two things – festive goodies and red packets. While snacking is a highlight, this article is inspired by the familiar red packets children receive.

As many of you know, red packets, also known as "hongbao" in Mandarin, come with a gift of money and are handed out to children, family members and friends as a symbol of good fortune. Naturally, my 13-year-old daughter is a big fan of this tradition. After all, who wouldn't enjoy collecting red packets from relatives and loved ones?

The act of giving made me think hard, though. Rather than just giving our children red packets as per tradition, can we do more for them?

Cultivate a saving habit

Firstly, every child should cultivate a healthy savings habit. Parents have a responsibility to inculcate good saving and spending habits by being role models themselves, as kids tend to mimic what their parents do rather than what they say.

Primary school children can be taught the value of money and get into the habit of placing their spare cash into a piggy bank. The money that is saved can be deposited into a bank account. Examples include the POSB Kids account I opened for my daughter.

But with inflation hitting close to 14-year highs in Singapore, simply socking money away in a bank account means its purchasing power surely will erode over time.

Never too early to start

Financial literacy is an important skill that is not taught in schools. Therefore, the responsibility falls on us, as parents, to impart these skills to our children.

It is never too early to start investing. In fact, one of the world's best investors, Warren Buffett, bought his first stock at age 11.

Now, some may argue that kids are not ready to make their own investment decisions. It is a fair point – but there shouldn't be anything stopping you from teaching your kids simple investment concepts and how businesses work.

Start simple by explaining the different investment options out there (for example, stocks, bonds, real estate) and how each works. Next, demonstrate what investing is about by showing them a business they are familiar with. It could be anything from a bubble tea shop such as LiHo and Gong Cha to supermarket operators such as **Sheng Siong**.

Since she was young, I have been sharing with my daughter about how I park money in stocks and how a stock represents part-ownership in a business. As these businesses churn out profits, I will be looking to them to share some of the spoils as a dividend. And if that business becomes more valuable over time as it grows, then its share price will also rise to reflect its business strength.

Parents can do more

Some parents have taken it a step further. An example is my friend, finance blogger Derek Lim at thefinance.sg. He started a portfolio for his child in June 2020 with an allocation of 60 per cent to equities and 40 per cent to bonds.

It is a great idea to open a segregated account for your children so that you can track the progress of their investments. When they reach adulthood and are better prepared to manage their own portfolio, the responsibility can be handed over to them.

This is the perfect gift from a parent to their child – the knowledge of how to put their money to work and the little pot of cash that has grown over time in their investment account.

Power of compounding

In case you're wondering whether it's a good idea to start a stock portfolio for your children, consider this: The power of compounding over decades can grow a small investment into a sizeable amount. The results will surprise you.

For example, my daughter was born in June of 2009. Now, if I had bought shares of Apple for her in July, I would have scooped up shares of the technology company at just US$5 apiece.

Nearly 14 years later, Apple has seen its share price multiply by nearly 27 times to its current US$135.

But if you think I am cherry-picking a date that's so close to the end of the great financial crisis, then let us take another two examples of stocks purchased and held for over 20 years. If you bought shares of coffee-chain Starbucks back in early 2003 and held them for over two decades, your investment would have grown close to 21 times.

Similarly, buying sports footwear giant Nike 20 years ago and holding its stock till today would see your money multiply by nearly 23 times. That is as good a reason as you can get for buying stocks when your children are young and then holding them over the long term.

Growing stream of pocket money

Let's not forget that good investments can also pay out increasing levels of dividends over the years. If you continuously invest money into your children's stock portfolio and buy well-run dividend stocks, you can end up with a significant amount of passive income by the time they hit their teenage years.

Real estate investment trusts (Reits) come to mind as reliable and consistent dividend payers. If you had bought 2,000 units of **Parkway Life Reit** 10 years ago, you would have forked out S$4,600.

Back in 2013, the healthcare Reit paid a distribution per unit (DPU) of S$0.1075, giving your child an annual dividend income of S$215. Today, those same 2,000 units would now be worth close to S$7,500.

Meanwhile, the dividend your child would have received has jumped to S$281.6, as 2021's DPU has increased to S$0.1408. This is just one example, and there are many others that pay out significantly higher dividends over time.

The trick, of course, is to start early. By giving your children a head start in investing, you can help to grow their funds while also generating a sizeable passive income stream. If done well, it could be their pocket money for life, and not just in their schooling years.

So, the next time your children run excitedly to you with their red packet money, think about putting some of it to work. By harnessing the power of compounding, you're doing your children a huge favour.

The writer owns shares of Apple, Nike and Starbucks. He is portfolio manager of The Smart Investor, a website that aims to help people invest smartly by providing investor education, stock commentary and market coverage.