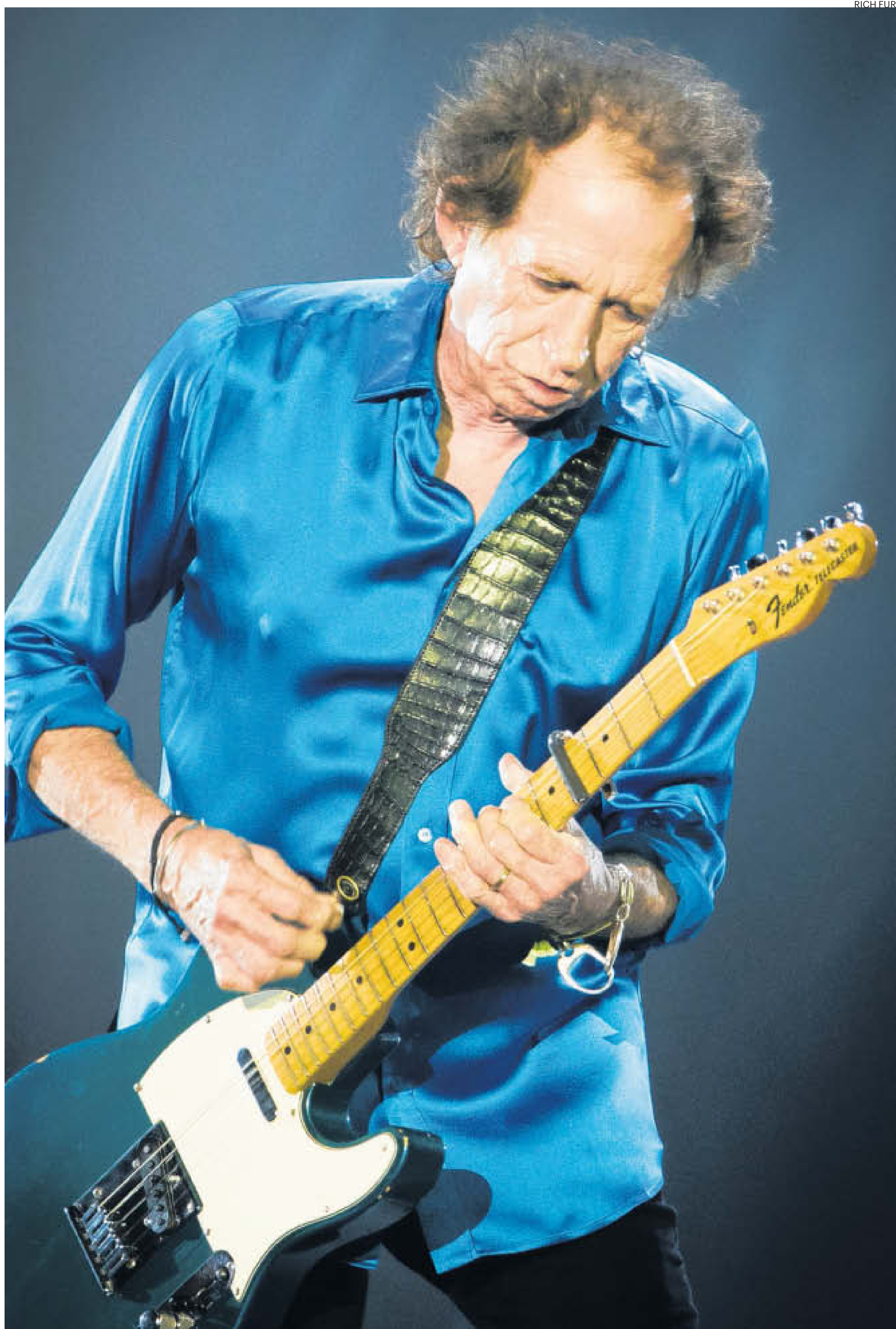
MONEY

MINIMUM NET WEALTH OF RICHEST 10% OF IRISH HOUSEHOLDS
€835,000
SOURCE: CSO. POOREST 10% HAVE LESS THAN €1,000

PROPORTION OF HOMEOWNERS IN NEGATIVE EQUITY
3.9%
DOWN FROM 31.9% IN 2013

Gimme shelter: cover to see you through sickness

Income protection and specified illness insurance are very different products, but we all need one to lean on when we're sick. *Eithne Dunne* gives them a health check


RICH FURY
Keith Richards of the Rolling Stones got his hands insured for about €1.5m, but you probably won't need that much cover

Although often filed away together in our minds under a vague "How will I pay for things if I get sick?" heading, income protection and specified illness insurance are two very different prospects. They both offer some form of financial back-up should you get ill, but that is where the similarities end.

Income protection will pay up to 75% of your salary each month, less any state benefit, should you be unable to work due to illness, injury or disability until whatever end date you specify. Specified illness cover – also known as serious or critical illness insurance – will pay a one-off lump sum should you contract certain illnesses.

If you must choose one of these types of cover, your priority should be income protection.

"All your plans for the future are based on your ability to earn an income," says Steven Barrett, managing director of Bluewater Financial Planning. "The state benefit won't be enough for most people."

Income protection

This cover pays out on almost any illness, accident or injury that renders you unable to work; examples include stress and back pain, neither of which will be entertained on a specified illness policy.

Price depends on various factors, the biggest being your salary, occupation and any deferred period, which is the waiting time after stopping work before starting your payout. Deferrals range from four to 52 weeks, so it is important to know for how long your salary would be paid if you could not work.

"You'll never get more than 75% of your salary from income protection, so if your employer would pay you for six months anyway, there's no point in being covered from 13 weeks," says Barrett.

Some occupations are deemed high risk and their premiums cost more, while others, for example those who drive for a living, are unlikely to get cover at all.

"That's because of the risk of back problems, which is one of the biggest reasons for claims," says Barrett.

Nick McGowan, of lion.ie, asks how much of your monthly income you would be prepared to put by to guarantee an income in the future, should you fall ill.

"Most people would happily pay 5%; on average their premium will be less than 2%," he says.

If you are being quoted too much, then try insuring a bit less of your salary, bringing your policy end date a bit closer or increasing your deferred period.

"It's better to push out the deferred period to 52 weeks rather than have nothing," says McGowan. "The average claim is paid for seven years, so while waiting 52 weeks may seem like an eternity, at least you'll have a piece of paper you can show the bank. Imagine seven years without an income."

Barrett says it is worth remembering that if your salary were to drop, you would get 75% of your salary when you claim, not when you took out the cover.

"After the Celtic tiger a lot of people took pay cuts, and you could have had someone on €100,000, with €75,000 worth of income protection cover. Then their salary halved, they were still paying for €75,000 in cover, yet the maximum income protection they could get was now €37,500 [75% of €50,000]."

The exception is company directors, for whom cover is based on their average salary over the previous three years. To avoid overpaying or not having as much cover as you think, review your cover if your salary changes.

If you would rather not, New Ireland has an option on its policies to guarantee that you get 75% of whatever your salary was when you apply, regardless of any subsequent pay cut, but it costs a bit more for the privilege.

In addition, if you have a pre-existing medical condition, some policies will work better for you than others.

"Let's say you had surgery on a slipped disc in the past," says McGowan. "Some insurers will add a spinal exclusion if you had symptoms in the last two years; some will look at only the last 12 months."

If you claim on your policy, cover continues as normal – you would not have to pay premiums while claiming. Should you have a relapse later, you would not have to serve your deferred period again. You would also get tax relief at your higher rate, so higher earners effectively get 40% off their monthly premiums.

Specified illness cover

Here the insurer is more interested in age, smoking status, health history and the amount of cover. Applicants also need to pick a specific term up to a maximum age of 75.

Barrett suggests a good starting point is to work out how much you would need to pay the mortgage for four or five years. "For most people, this is their biggest outgoing, and if you get sick you'll get the payout and have the money in advance."

McGowan reckons about one to two years' net income is a good figure to choose.

Should you claim on your specified illness policy, it will end straightaway. If you wish to take out a new policy, it will come with an exclusion for the illness that caused the claim. So if you claimed for breast cancer, for example, your next policy would have a full cancer exclusion, says McGowan.

Although McGowan says income protection should take priority over specified illness cover, there are some cohorts – such as stay-at-home parents – for whom specified illness is the only option. They have no income to protect, yet paying someone else to take over childcare and other duties if they became ill could cost as much as €44,000 a year, according to recent research from Royal London. For this reason, McGowan recommends homemakers take out specified illness cover.

Cover can be bought as a standalone policy or as an add-on to life or mortgage protection policy. McGowan advises against tying it in with mortgage protection, as any payout would go to the bank first, for your mortgage, rather than to you. If you are taking it out with a life policy, investigate how it might affect your main life cover.

Specified illness cover tends to be indexed or convertible term cover. Indexation raises cover in line with inflation but your premiums will also increase; Barrett says it is not always worth the extra costs, because financial needs diminish as you get older.

Convertible term cover – which McGowan recommends, but which will also cost extra – allows you to convert your cover into a new policy when it ends, regardless of any changes to your health in the meantime.

> **A multi-claim protection cover payout is usually piecemeal, depending on need**

A new type of cover

Royal London offers multi-claim protection cover, which will pay out multiple times for different illnesses, or for different aspects of the same illness, up to your insured amount. Essentially, it pays per treatment rather than per diagnosis.

"To take the example of cancer, a person may go into remission but it could come back at a later date," says Barry McCutcheon at Royal London, "or they might suffer another unrelated illness and need treatment."

Multi-claim protection cover does pay out 100% in certain circumstances, including death, unlike specified illness cover. But the payout is usually made piecemeal, depending on your needs. For example, you get 20% of the sum insured for chemotherapy, 5% for angioplasty. The remainder is then available should you need it later. This contrasts with traditional specified illness cover where payout is always a 100% lump sum and the policy ends.

McCutcheon says the new product, which is aimed at younger people, works out about 23% less expensive than traditional cover.

McGowan says this cover comes into its own with existing conditions such as MS or diabetes. "Both of these rule you out for income protection and specified illness cover, but you can get multi-claim protection cover with exclusions."

QUESTION OF MONEY

I have a lump sum of €150,000, from an inheritance; I've already paid capital acquisitions tax and so on. Ideally, I'd like to invest it in equities, but I don't think this is an option as I am also considering buying a house in the next two years and I'd need this then. As far as I know, this is far too short a time frame to invest in equity markets — it's too risky if I can't leave it there for longer.

Am I right in this? What are the best alternatives for this money in the meantime? I don't have debts that I need to pay, and I'm already paying into a pension.

Anon, Co Kilkenny

First, I am sorry to hear about the nature of the windfall and I am assuming all tax has either been paid or is within the threshold of gains. From the point of view of investing, I agree with you that equities must be viewed as a longer-term investment than up to two years.

While the life assurance companies are now promoting easy access accounts to encourage people to invest without early penalties, it is certainly a more risky strategy. I would add, however, that I certainly wouldn't invest solely in equities (shares) with this sort of money. Equities are a high-risk category of investment and typically fall into risk category seven on a risk scale of one to seven.

Even investment managers who invest in equities through, say, pensions and generally take a long-term view would typically have some cash, bonds and property in the mix. Generally, the shorter the time frame, the more you'd have in more secure assets, such as cash and bonds, and the less in equities.

Never mind the fact that the Faang stocks (Facebook, Apple, Amazon, Netflix and Alphabet, the parent company of Google) have carried the market for the past few years, I would tread carefully if investing now. Last year was one of the best returns from the market since the crash, which makes investment managers more wary.

So, while it pains me to say this, there is only one alternative for money over two years and that is a deposit account. We all know interest rates are negligible and it is an extremely difficult time for depositors, with banks pretty much acting like vaults. The best rates are currently about 0.5% per annum. For €150,000 this would equate to €750 gross. Given Dirt is taken annually at source, this means 33% is deducted from this amount, so the net return is about €500. So if the money were held for two years you would receive a miserly €1,000. The post office options are typically the same and the timescale is actually three years.

You mention paying into a pension. That is a tax-efficient investment from the point of view of getting tax relief at the marginal rate and tax-free growth, but due to the constraints of the timescale involved it is not relevant for these funds.

Nick Charalambous is an independent financial adviser with Alpha Wealth

Send your personal finance or consumer-related questions to money@sunday-times.ie

Rory Gillen

Recognise the value of Dow and invest for the duration

It's over 120 years since Charles Dow, founder of the Wall Street Journal, postulated his theory on markets. He did so with only a dozen years of data to reflect on.

A central tenet of what is now generally known as the Dow Theory is that there are simultaneously three movements in progress in markets.

The primary trend is that the market is either in a medium-term uptrend or downtrend. There are inevitable reactions against that primary trend, and these are referred to as secondary movements.

The latter are deceptive and represented by sharp declines in an ongoing bull market and sharp rallies in an ongoing bear market. The coronavirus outbreak has helped to pare 3% off the S&P 500 in just such a secondary movement, leading it into negative territory for the month.

On occasion, a secondary reaction turns into more than that and results in a change in the primary trend from a bull to a bear market, or vice versa.

The third type of trend is daily movements, and these exist concurrently with the primary and secondary movements.

Daily movements are largely irrelevant. If you are trying to time the markets, the primary trend is key and secondary reactions must be watched closely for their potential to lead to a reversal of the primary trend.

Those who trade short-term movements in markets are up against two uncomfortable facts. First, the daily movements hold no clue as to the long-term trend. Second, markets are a zero-sum game over shorter timelines, so that a trader can only win off the loss of another.

While some professional traders can find a "trading edge", there is generally no hope for the private or retail investor to beat the zero-sum odds in markets. Yet many try. In sport, an amateur almost never beats a professional. Yet many private investors think that it is different in markets.

By contrast, everyone can benefit from the wealth creation of companies (and property) over the long term. In the long term, the stock markets are not a zero-sum game.

Businesses create wealth, and that process manifests itself in markets rising over time. The American Stock Market, as represented by the S&P 500 Index, has delivered returns of 10.3% compound per annum from 1970 to 2019 inclusive.

That 10.3% annual return had three components to it. Dividend income averaged 2.91%. Company earnings grew at an average 6.6% annually and underpinned share prices gains of the same magnitude.

The final 0.9% annually came from the fact that investors in 2019 were paying an average of 23 times company earnings compared with 16 times at the outset of 1970.

True investors know it is a fact that companies, in aggregate, generate a high return on the capital invested in them, which, in turn, generates both dividends and retained earnings. The reinvestment of retained earnings drives further growth going forward.

The make-up of corporate earnings growth in the S&P 500 Index over the 50-year period is also revealing. In 1970, the US headline corporate tax rate was 47% but was down to 21% by 2019. That contributed 0.9% of the 6.6% annual earnings growth over the period.

And share buybacks, which reduce the share count and therefore lift earnings, are estimated to have accounted for 0.3% of that annual earnings growth since 1970.

Lower tax rates are, by definition, one-off. With the dividend payout ratio in the US only marginally below the 50-year average, one can reasonably conclude that share buy-backs have largely been financed with debt as opposed to cash flows. This suggests that their impact has probably also been one-off in nature. Underlying earnings in the S&P 500 Index then grew at circa 5% per annum over this 50-year period.

Looking forward, investors should probably settle for much lower returns from the US equities. Lower GDP growth, a lower starting dividend yield of 1.8%, and the absence of one-off boosts from tax cuts and share buy-backs suggest sustainable earnings growth in the 4%-5% range and total annual returns in the order of 6%-7% annually. And that's assuming that investors continue to pay today's higher multiple of earnings.

History is waving a yellow card in terms of the likely returns from here. As Charles Dow also said: "To know values is to know the meaning of the market."

Rory Gillen is the founder of Gillen Markets, an investment advisory firm