Saving vs investing: how hard is your money working for you?

By Gabriel Botha, Prescient Retail Business Development

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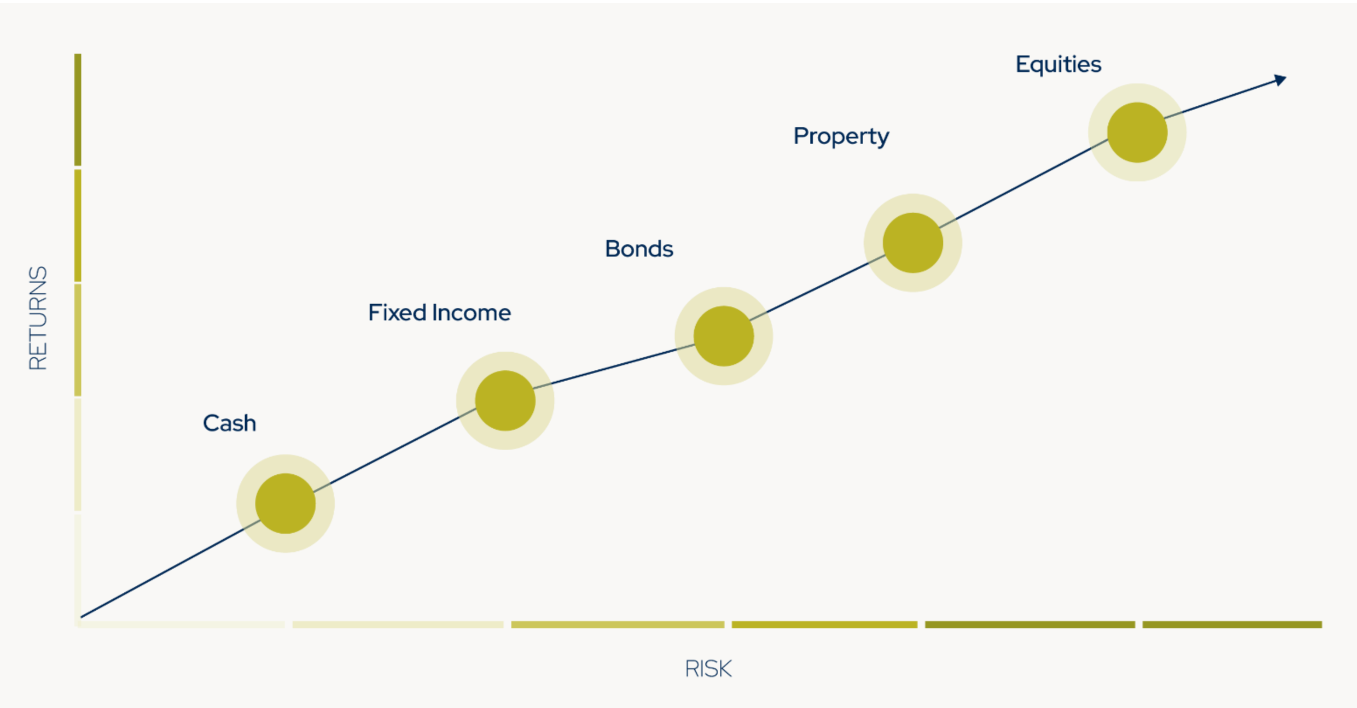
As kids, we were told to save — save in our bank account, or in our piggy bank. What we didn't realise then is that if we had invested our money instead, we would have been further on the path to unlocking our financial freedom.

Most people view saving and investing in the same light due to the similarities between them. One of the most notable similarities is that both involve saving towards a future goal. However, the key difference between the two lies in the asset class that you invest in. Investing involves putting money into more risk tolerant assets with the potential for higher returns, while saving is limited to cash-only assets (more risk averse) with lower returns.

What is the difference between saving and investing?

Let's look at the below illustration from Prescient Investment Management, showing how different asset classes have the potential for higher returns. You can see money in the bank is invested in cash only, and that is the point furthest to the left (saving). To make your money work harder, you must move to the right, but this comes with more risk (investing).



At the end of the day, it comes down to how hard your money is working for you. Your money needs to equal the inflation rate to ensure you're not getting poorer and outpace the inflation rate if you want to grow your wealth. Certain asset classes that we will discover below, provide a better outcome for long term outperformance of inflation.

Below are some practical examples of risk and return for asset classes:

Asset class	12-month return to end June 2024	Inflation	Return after inflation
Cash (STEFI)	8.22%	5.2% (May 2024)	+3.02%
SA Interest Bearing Money Market (Mostly cash and fixed income)	8.7%	5.2% (May 2024)	+3.5%
SA Interest Bearing Variable Term (Fixed income)	12.62%	5.2% (May 2024)	+7.42%
Global Equities General (Equities)	12.87%	5.2% (May 2024)	+7.67%

In our current higher interest rate environment, we have the unique scenario where money in the bank keeps pace with inflation. Over the long run money in the bank struggles or does not keep pace with inflation as inflation is often higher that the returns you receive in a normal bank account. The 5 years inflation number is 4.96% and cash rate is 5.64% meaning your money is hardly creating wealth for you. As you start taking on more risk and investing in riskier asset classes you will notice your return after inflation increases.

Rule of 72 and rule of 114

The risk versus return trade-off can be evaluated using the rule of 72 and rule of 114.The rule of 72 calculates how long it will take for your money to double given a rate of return.

The rule of 114 calculates how long it takes to triple the value of your money by using the same method used for the rule of 72.

On your journey to financial freedom, it’s important to ensure you’re outpacing inflation by looking at the different asset classes and the value that they offer in terms of their long-term outperformance. So, how hard is your money working for you?