THIRD EDITION

STARTING OUT IN SHARES

THE ASX WAY

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Introduction

These days more people than ever before have an interest in the sharemarket. It is easier and cheaper to buy and sell shares, there is more information about the market and most of us have a stake in the performance of the market through our superannuation funds.

So, if you are reading this introduction, you too have probably decided that you want to know more about investing.

But where to start?

Starting Out in Shares the ASX Way is a good place to start because for more than 30 years the Australian Securities Exchange (ASX) has been educating people starting out in the world of investing.

You may not know:

- what a share is
- how the sharemarket operates
- how to buy and sell
- what you need to have ready before you get in touch with a stockbroker.

We will walk you through all this and a lot more as well.

People often get a bit overwhelmed about investing in the sharemarket because, for many, it is unfamiliar territory with unfamiliar language. We will try to avoid jargon as much as possible, but we will explain terms to you that you are likely to encounter when you step into the world of investing.

Part I of the book intends to get you thinking about why you want to invest, what your objectives are and the various choices you have. We go into detail about how to buy and sell shares and how the market operates. In Part II we get into the nitty-gritty of having a balanced portfolio and how to set up an investment strategy.

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By the end of the book we hope you have a good overview of the basics of investing and can confidently take your next steps in your investment journey.

PART I
The basics of the sharemarket

Starting Out in Shares the ASX Way aims to explain what shares are and how to buy and sell them. The book is targeted at people who are new to share investment. Part I of the book compares the benefits of shares over other investments, how the sharemarket works and how to set yourself up for share investment.

CHAPTER 1
Getting ready to invest

When you turn your mind to the prospect of investing in the sharemarket there are a lot of different aspects to consider. Why do you want to invest in the market? What are your investment goals? Consider whether your objectives are sound and realistic and how you are going to achieve them. This leads to thinking about mapping out your investment strategy. Then there are the practicalities of actually investing — that is, of *doing* it.

Saving versus investing

Saving involves setting money aside in a safe place in the hope that you will accumulate an amount sufficient to cover your future financial requirements. You can improve your chances of success by reducing your living expenses and lowering your lifestyle expectations. People with a strong savings mentality are good at this. Following this strategy means that your money may be safe as there is little chance of losing it. However, there is little you can do to protect its buying power from the debilitating effect of inflation.

Investing, on the other hand, makes your money work for you. Investors look for opportunities to put their money to use so that it may grow and create greater wealth for them. They assess alternative investment opportunities in terms of the potential risk involved, weighing them against the potential return to be made from the investment.

Strategies that take both inflation and taxation into account will improve your success as an investor, as will diversifying your risk across a range of investments.

What is your current life situation?

Your own personal circumstances, responsibilities and obligations will be major factors in determining your ability to invest and what you hope to achieve. You should consider the following:

- *Age and expected time remaining before retirement* — how much time do you have to achieve your goals?
- *Occupation and employment status* — do you have job security and a reliable income, or are you self-employed or a pensioner?
- *Spouse's age, occupation and retirement plans* — have you included your spouse's or partner's situation in your planning?
- *Family and dependants* — do you want to provide for your children's education, for example, or other needs?
- *Plans for your family home* — do you own your family home and will you sell it when you retire? Will you buy another home?
- *Standard of living* — what are your standard of living expectations, including holidays, entertainment and luxury items?
- *Estate planning* — have you planned for any future distribution of your wealth?
- *Personal control* — how much control do you like to have in managing your financial situation?
- *Insurance* — are you adequately protected against risks to your property, possessions, income and wellbeing? It is important to insure your assets against loss. If you are earning an income, you are your most valuable asset and

it is important to consider insuring your income against loss through illness, accidents or disability.

Current financial position

It is important to take stock of your current financial position, as it will affect your ability to raise funds for immediate investment. Also, your stockbroker or adviser will require information about your current position in order to provide you with suitable investment advice.

There are some excellent online calculators on the MoneySmart website (www.moneysmart.gov.au). MoneySmart is an initiative of the Australian Securities and Investments Commission (ASIC), which provides a wealth of general financial resources beyond investing in the sharemarket.

Goals

Take a moment to reflect on your goals:

- How much money should I invest?
- Where should I invest — the sharemarket, cash or property?

Goal setting means thinking about what is important in the medium to long term, how much those goals will cost and how you plan to afford them.

How much money do you have to invest?

The amount of capital you have available for immediate investment will include the value of your current investments, any surplus after-tax income and, potentially, the value of some of your general assets if you are prepared to sell or borrow against them.

Risk — what it means to me

Investment risk refers to both the possibility of loss and uncertainty about future conditions.

Your attitude towards risk will affect how much money you make available for investment and how you invest it. To determine your risk profile, you should consider the following questions:

- How comfortable are you with risk and not being able to control some aspects of investment?
- Are you prepared to expose some of your money to higher risk for the opportunity of making higher returns, or are you more comfortable with low-risk, low-return investments?
- How reliable is your income and are your budgeted expenses realistic?
- Do you have a large amount of debt?

Time frame — income and capital growth

Timing is another factor in determining your investment objectives. If you need funds to achieve short-term goals, you should invest in areas that are more likely to perform earlier rather than later. Alternatively, you may wish to grow your investments over the long term.

Requirements regarding timing, as well as your current lifestyle needs, will determine the returns you should seek from your investments.

When considering how timing may affect your investment objectives, ask yourself whether you require:

- a return in the form of income to support your current lifestyle
- a return in the form of capital growth to increase your wealth over time
- a combination of income and capital growth.

Diversification

A popular saying is ‘don’t put all your eggs in one basket’. It can apply to many things, but it applies particularly well to investing in the sharemarket and the need for diversification.

Markets move in cycles. Some investors fall into the trap of putting all their money into one asset class — usually when it is at its peak — and then watch as another asset class takes off without them (an asset class is an investment area such as shares or property). The sharemarket is one asset class you can use to diversify your portfolio.

There is much debate as to how many stocks you should invest in to achieve prudent diversification, and this is something you need to consider and discuss with your adviser if you have one. Some advisers recommend having more than 20 stocks; others suggest that with a wary eye to correlation you can create a reasonably diversified and balanced portfolio with 10 or 12 stocks.

Are you ready to start investing in shares?

Once you have assessed your current financial situation and developed your future plans, you should be ready to start looking at different investment strategies and working out which strategies best suit your needs and objectives.

So if you’re ready, let’s get started!

CHAPTER 2
What is a share and what is the sharemarket?

A share is simply part-ownership of a business. A company can raise money to finance its business by ‘going public’. Going public means being listed on a stock exchange and issuing shares to investors. When you buy shares in a company, you own part of that company.

The money that a company raises in the sharemarket is called ‘equity capital’. Unlike debt capital, which is borrowed money, equity capital does not need to be repaid as it represents continuous ownership of the company.

As a shareholder you have certain rights and obligations, and you also share in the risks associated with the fortunes of that company.

Shares in a listed company can be sold to other investors on the sharemarket. In this way, you can realise capital gains if the share price has risen — in other words, you can make a profit by selling the shares for more than you paid for them. As a shareholder you may benefit by receiving income in the form of cash distributions, called ‘dividends’.

As a part-owner in the business you may be entitled to vote on the direction of the company, the election of new company directors or other matters.

All shareholders should be aware that the value of a share can fall to zero. In the case of a company going broke and being wound up, shareholders rank close to last in the list of people who can claim money from the sale of the company’s assets.

What is the sharemarket?

There are a number of approved securities exchanges in Australia, the largest of which is the Australian Securities Exchange (ASX), which has more than 2000 companies on its Official List.

The sharemarket may be thought of in terms of its two separate market functions: the primary market and the secondary market.

The primary market — where it starts

If a company wants to set up a new business or expand its existing business it can raise the money (capital) it needs by issuing new shares to investors. The investors who invest money by buying these shares become shareholders in the company.

Companies that want to issue shares on the sharemarket must first be listed on an approved securities exchange. Most get listed on the ASX. The requirements for listing include being large enough to achieve a market in its shares and agreeing to abide by the ASX Listing Rules. These rules require listed companies to inform the sharemarket of any activities that may affect the price of the shares on the market and to report company profits and other specified financial information.

Many people invest in the sharemarket by participating in the initial public offering (IPO) of shares made by a company listing on the ASX. Access to public floats can vary considerably depending on the size of the float, how many shares are being made available, whether a large portion is allocated to institutional clients or retail investors, and of course whether there is a demand for shares in the company.

The terms ‘IPO’, ‘float’, ‘listing’ and ‘going public’ are often used interchangeably.

The secondary market — where people buy and sell shares

After a company has completed its float and issued shares to investors, the shares can be sold to other investors on the sharemarket. This is referred to as the secondary market.

Share trading takes place through the agency of stockbrokers who enter buy and sell orders on behalf of investors.

The price of the shares is determined by the forces of supply and demand, with investors deciding what they will pay for shares in individual companies or what they will accept for shares they already own. The growth and profitability of the companies, alongside other external factors, influence these decisions.

* * *

Now that you have an understanding of the market itself and the difference between the primary and secondary market, it is time to talk about your choices when it comes to investing.

CHAPTER 3
The main investment areas: cash, fixed interest, property, shares

This chapter contains general factual information on the main investment areas and does not constitute financial advice. You should seek independent advice from an Australian Financial Services (AFS) licensee prior to making any investment decisions.

Financial advisers are often asked, 'Where is the best place to invest my money?' In asking such a question, their clients might be hoping to be told that there is one sure bet — for example, that shares are better than interest-paying investments or that property is the best method of increasing wealth. Of course, depending on your financial goals and objectives, one particular form of investment may be better than another for you at a particular point in your life. However, it is never advisable to have all your eggs in one basket. Even the so-called safe investments such as bank savings accounts involve an element of risk — most notably the risk of the value being eroded by inflation.

In general terms, there are four main types of investment, often referred to as asset classes:

- *Cash* — where you invest money in a building society, bank or other financial institution. Investment options include cash management accounts, and a major benefit of this investment type is liquidity.
- *Fixed interest* — where you invest in short- or long-term interest rate products that provide a steady income stream. Investment options include bonds, deposits, bank bills and various other types of securities. For

more information on fixed-interest products, go to the ASX website: www.asx.com.au.

- *Property* — where you invest in residential, rural, industrial or commercial property. Depending on your retirement plans and financial objectives, your home may be included in this investment class.
- *Shares* — where you invest in companies listed on the ASX and other stock exchanges.

Investment considerations

Evaluating investment opportunities is easiest if you use a standard set of criteria to measure and compare them. Each investment should be evaluated in the context of your goals and objectives and then the following characteristics (among others) should be considered:

- return on investment
- capital and income security (or risk)
- ease of investment
- liquidity and other market conditions
- minimum investment
- costs
- time frame for performance
- choice and ability to diversify
- taxation.

Return on investment

Return on investment is usually in the form of income (a payment you receive from your investment) or capital growth (where the value of your investment increases over time). Some investments, such as shares or property, may provide both.

Income

Investment income includes amounts such as interest on bank accounts, dividends from shares, rent from a property and distributions from a trust. As well as the amount of income you are likely to receive, you should consider the likely frequency of the payments and the potential for any increases or bonuses. As income from investments is usually subject to income tax at your marginal tax rate, you should always take the income provided after tax into account. Some forms of investment income, such as fully franked dividends, may provide some investors with tax benefits; however, we recommend that you obtain your own taxation advice from a professional adviser before making any investment decisions.

Capital growth

Returns from capital growth can only be realised when you sell an investment for more than the purchase price. The main benefit of capital growth is that it protects you against inflation. Capital growth may occur through rising share and unit trust prices on the sharemarket, increased values in the property market, and/or profit on fixed-interest securities if sold before maturity. Realised capital growth from investments is usually subject to capital gains tax.

Visit the website of the Australian Taxation Office (www.ato.gov.au) for up-to-date information on tax matters.

Capital and income security

How secure is your investment capital? Is it possible your investment will be worth less when you wish to sell it? Will