Money and risk management

You're in the middle of a basketball game and the opposing team is continually breaking through your defence and shooting goals.

What will you have to do if you want to win…shoot more goals?

Well, maybe, but perhaps the better strategy would be to defend, stop them from shooting goals and then get the ball down your end. Defence needs to come first and then you can shoot the baskets.

So what's this got to do with investing? Well, one of the things you need to think about is how you will protect your investment. Yes you want to make money, but if you don't protect it in the first place you may not get very far.

Your goal first and foremost is to preserve your capital – your $50,000.

In doing this you want to be able to cut your losses (defend) and let your profits run (attack).

It is important to remember that the sharemarket can be risky.

The sharemarket doesn't always go up!

Graph 1

Take a look at this chart of the All Ordinaries Index from 2012 – 2014

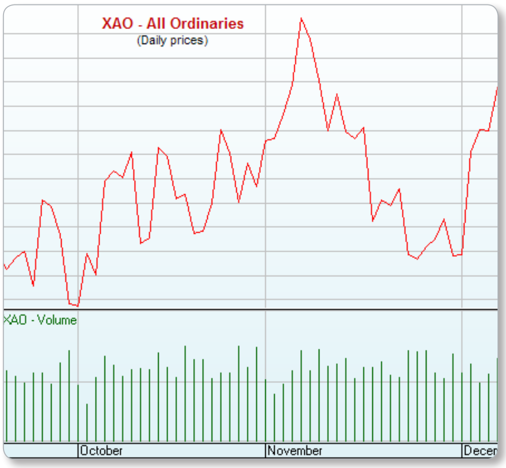
In looking at this 3 year period, you may think that the market always goes up…however, take a look at the next chart.

Graph 2

The All Ordinaries Index: 2005 – 2014

You can now see that the market also goes down. The period from late 2007 to early 2009 is known as the Global Financial Crisis. As you can see, it would have been very important to have risk management strategies in place in order to survive this downward market.

(Continued over)



Graph 3

Now look at this 3 month period – of the All Ordinaries Index

Volatility means the market is moving up and down a lot. In this chart there is a lot of volatility. Now if you were invested over a longer period of time, this type of movement may not bother you that much (because the market is moving more sideways rather than up or down). However, if you are investing over a shorter period (as in the Game) it highlights the need to manage your risk and to have a plan.

So when investing in the sharemarket it is vital that you manage your risk.

If you have money invested in the Sharemarket Game and the market starts to become more volatile (as in graph 3) what do you think you could do to protect your portfolio?

Protecting your portfolio

Here are some ways you can protect your portfolio.

The first level of defence:

Don't put all your eggs in one basket

Invest in 2 to 3 different sectors.

If you put all your money into one sector and that sector falls, this is not going to help you preserve your capital. Also if you were able to put all your money into one company and their shares dropped, again you would potentially lose a significant amount of money.

In the Game you are not able to invest all of your dollars into one company; you have to invest in at least four.

So, already you have started to manage risk.

A good idea is to go back to the section on industry sectors and see how these sectors have performed over the past year. Look at the companies you have chosen. Which sectors do they fit into? Make sure that you are investing in at least 2 to 3 different sectors.

Ask yourself:

- Have you invested in more than one sector, if so which ones and why?

- If you have not yet invested, what sectors do you think you might invest in? (For more help on sectors see Quickstart guide 2: Company research)

ASX Schools Sharemarket Game

Student Lesson: MONEY & RISK MANAGEMENT

The second level of defence:

Your position size

How much will you invest in each company? Some students start off by investing $1000 – $2000 in a company. Be careful of this because every time you buy or sell you
are paying brokerage and this can add up very quickly. Plus if some companies do really well you want to own enough of these shares to make some good profits.

The third level of defence:

Decide whether you will invest defensively or aggressively

In the sharemarket you will find that there are companies that are known as defensive companies and those that are known as aggressive companies. Aggressive companies are also referred to as cyclical stocks.

When choosing whether you will invest aggressively or defensively, you will also need to decide on what you think the market is going to do
e.g. keep going up, move sideways or fall.

Listen to the audio 'Aggressive vs. Defensive' (recorded 2009) and answer the questions on the next page to work out whether you will be aggressive or defensive in the Game.

Link to audio:
https://game.asx.com.au/static/media/aggressive_vs_defensive.mp3

Aggressive vs. Defensive

1) What does it mean to be aggressive?

2) What does it mean to be defensive?

3) What are defensive stocks – give an example of a type of business that is defensive?

4) What are aggressive stocks – can you give an example of a business?

5) Is a bull an investor who is aggressive or defensive? Why?

6) Is a bear an investor who is aggressive or defensive? Why?

7) If you think the market is going to go up, what type of stocks would you buy? Aggressive or Defensive?

8) If you think the market is going to go down, what type of stocks would you buy? Aggressive or Defensive?

9) What things do you need to think about before setting up a strategy?

What will you be?

Aggressive or Defensive