GETTING READY TO INVEST

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SAVING AND INVESTING

You may have a part time job or have some way of earning money each week while you're still at school. So if you earn an income, it's time to learn about savings and investment.

Have you ever thought about "paying yourself first" by putting aside 10 percent of your earnings/allowance before paying your other expenses? Putting aside money on a regular basis for future use is called saving.

If you are saving, you're on the right track but it's also worth thinking about using the money you have saved to make more money. When you invest you decide to commit your money for a certain time period in the hope that it will GROW in value.

Investment alternatives

There are many different types of investments to choose from.

1. Cash investments You may choose to simply put your money into a savings account where you loan your money to the bank and in return receive interest. Savings accounts are low risk investments and the interest paid is relatively low compared to other investments. There are other products such as Cash Management Trusts and Term Deposits so check with your bank or credit union to find out more about these investments.
2. Collectibles These are items that are relatively rare in number such as works of art, sporting memorabilia, antique furniture etc. Some of these investments can rise by large amounts. For example, the Australian Government bought the painting called 'Blue Poles' by the American artist Jackson Pollock in 1973 for $1.3 million. This was regarded as a huge amount of money at the time. Experts say the painting would now be worth more than 25 times the price paid for it.

Learn about...

- IMPORTANCE OF SAVING AND INVESTING
- INVESTMENT ALTERNATIVES
- RISKS & REWARDS ASSOCIATED WITH SHARE INVESTMENT
- ESTABLISHING INVESTMENT OBJECTIVES

KEY DEFINITION DIVERSIFICATION:

Spreading investments over a variety of investment categories to reduce risk.

FAMOUS QUOTE

"An investor without investment objectives is like a traveller without a destination."
Ralph Seger

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3. Property You may purchase land and/or a building in the hope that you will sell it at a higher price and make a profit. You can also invest in property through the sharemarket using a listed property trust. People often talk about the property market as if it is just one thing. But remember that different parts of the property market can move in price just like different shares can move at varying rates. For example, a house by the harbour in Sydney might change in price differently to a house in a small country town. Property prices in Perth increased a lot due to the mining boom but in other places prices did not rise so quickly, and in some places, have even fallen.

   Property investment appeals to a lot of people because they can see it - bricks and mortar. There can also be some tax advantages for investors. On the other hand, property costs a lot of money compared to other investments and may not be so easy to sell quickly if you need to.

4. Shares are another investment alternative. We will look at some of the risks and rewards involved when investing in shares.

ACTIVITY ONE

You're never too young to start saving and investing. In fact there are some great financial rewards to be had if you start investing at an early age.

1. For example, if you invest $500 today for one year earning 10% per cent per year, your investment will have earned you $50. You can either take $550 at the end of the year or reinvest that $550 for another year and if it still earns 10 percent you'll have earned another $55. Your initial $500 will now be worth $605 ($50 in the first year and $55 in the second year). Explain why you earned more money in the second year than the first?

   Answer

2. Here's an interesting story: "My grandfather knew the importance of saving but didn't really know about investment. He saved all his coins in a tin under the house for years. Unfortunately the rain got into the tin and the coins were rusty. He was still able to use his rusty savings but didn't actually increase the value of his money. In fact, he might have been better off spending his money considering inflation occurs when the price of goods and services rise."

   What does the writer mean by stating that her grandfather "knew the importance of saving but didn't really know about investment"? Ask your own parents or grandparents about their attitude towards saving and investing.

   Answer

ACTIVITY TWO

1. Can you think of some collectibles that have gone up in value by a large amount?

   Answer

2. What might be some of the problems in having these investments?

   Answer

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SHARE INVESTMENT - RISKS AND REWARDS

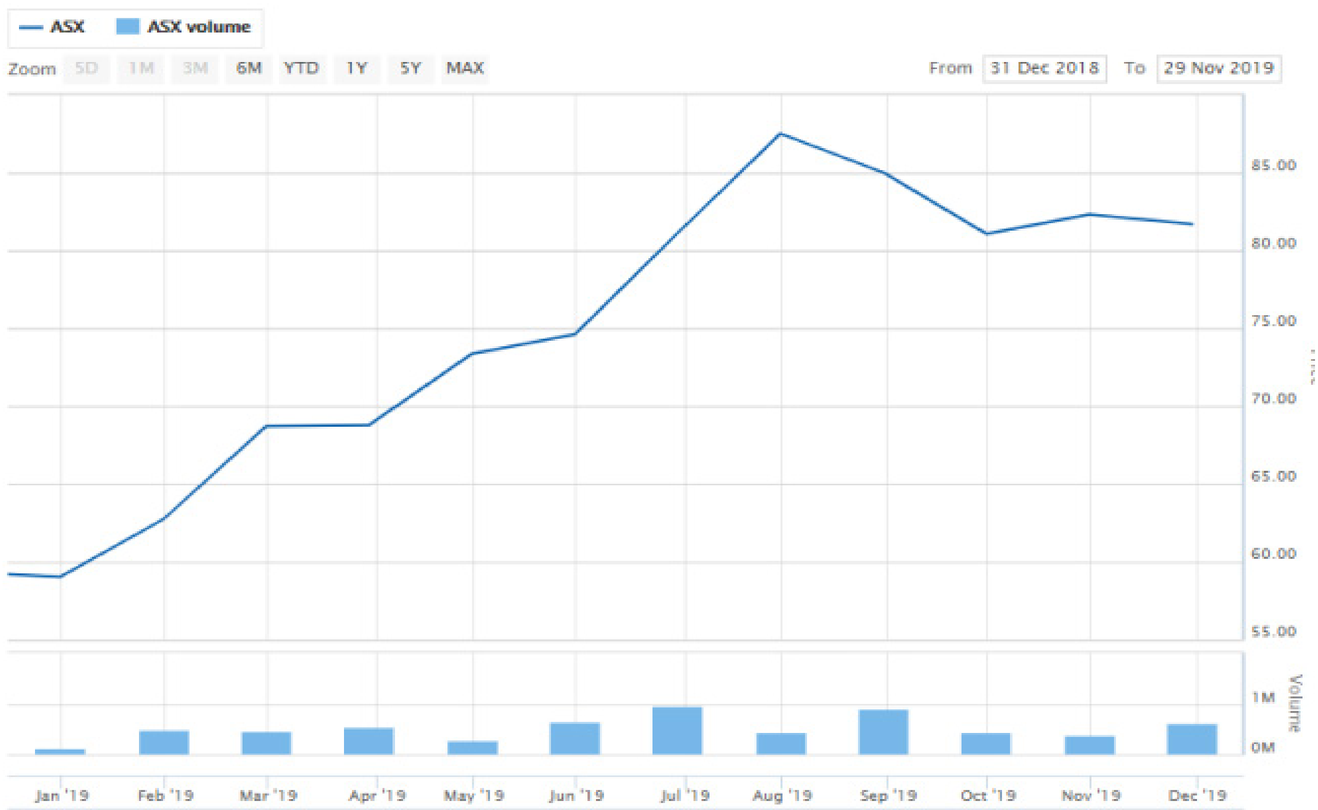
Australian share price movements

As you can see the sharemarket has been a profitable investment over the long term. But it has ups and downs and of course not all shares go up at the same time. While many may be going up some will still be going down. Suppose the market was rising but you owned shares in a copper mine and copper prices were falling. Your shares might be going in the opposite direction to most of the market. Something else to consider is when you buy and sell. Suppose you bought your shares at a market peak and then sold them when the market had fallen? Your investment will have done much worse than if you bought during a low period and then sold at the top of the market. Investing is about timing your buying and selling just as much as deciding what to buy and sell.

The performance of companies can vary too. Even the biggest companies can have periods when their share price falls. The saying "don't put all your eggs in one basket" can also apply to investing in shares. If you drop the basket – you lose all your eggs. If you have invested in just one or two companies and their prices fall by a lot, then you are likely to be in more financial trouble than if you spread your risk across a range of companies in a range of industries.

ACTIVITY THREE

Capital gain ASX monthly share price chart and table, December 2018 to December 2019.



Date	Dec 18	Jan 19	Feb 19	Mar 19	Apr 19	May 19	Jun 19	Jul 10	Aug 19	Sep 19	Oct 19	Nov 19	Dec 19
Closing share price ($)	58.18	61.84	67.72	68.91	73.50	74.74	81.27	87.17	85.16	81.07	82.32	81.71	78.41

1. The above table and chart tracks the share price history for ASX from December 2018 to December 2019

   Question: What would your profit/loss in dollars and cents be if you had bought 1000 ASX shares in December 2018 and sold them in December 2019?

   Answer:

2. What would be your percentage profit/loss have been if you bought in February 2019 and sold in October 2019? Round your answer to one decimal point.

   Answer:

3. During 2019 ASX paid two dividends. In March it paid $1.14 per share and in September paid $2.43 per share. If you owned 200 ASX shares how much dividend income would you have received in 2019?

   Answer:

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TAX BENEFITS

If you sell shares at a price higher than what you initially purchased the shares for you will have made a capital gain and will pay capital gains tax. However, if you hold shares for 12 months or more you qualify for a 50% discount in capital gains tax payable.

If you hold shares you can also gain income if the company pays its shareholders a dividend that may also be subject to tax. However, companies that have already paid tax on their profits may give tax credits known as franking credits that may reduce the tax payable by you on other income.

DIVERSIFICATION

"Don't put all your eggs in one basket" - What does this mean?

Obviously eggs are fragile and could break easily. So, by spreading your eggs across several baskets you are reducing the risk of breaking all your eggs at the one time. Get it?

It's the same with investment.

No one knows for certain how different types of investments are going to perform in the future. Selecting a range of investment options reduces the risk of losing all your money (breaking all your eggs at the one time). If one of your investments performs badly you may still have gained from your other investments.

At the beginning of this lesson we introduced the concept of different investment types such as property, cash and sharemarket investments.

Property provides scope for diversification between residential and commercial property. It is important to consider diversification between different locations within a town and between different states.

On the Australian sharemarket there are over 2000 companies to choose from so there is certainly plenty of opportunity for investors to diversify within the sharemarket. These companies are involved in a wide range of industries covering most sectors of the economy including financial services, industrials, healthcare, mining, telecommunications and energy.

Sectors are industry classifications. In general, companies in the same sector will have the same market influences working on them, although every company is different. For example, gold prices and gold mining companies, retailers and consumer spending, agricultural companies and the weather.

Of course you don't want to take this too far by having just a few shares in a lot of companies which might happen if you don't have a lot of money to invest. Plus you would end up paying a lot of money in brokerage (the fee you pay a stockbroker to buy and sell your shares). Opinions differ on what is a good number of companies for spreading your risk and it depends on whether they are doing similar activities. Some people are comfortable with 5-10 different companies while others might want to increase to 20 the number of different companies they invest in.

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When markets are in a general decline most prices will fall however by spreading your shares across different industries you spread your risk. The table below shows how different sectors performed over 2017/18 and 2018/19.

SHARE INVESTMENT – RISKS AND REWARDS

29 DECEMBER 2017 TO 31 DECEMBER 2018		PERCENTAGE CHANGE
XDJ	Consumer Discretionary	- 10.67%
XEJ	Energy	- 10.87%
XFJ	Financials	- 14.78%
XHJ	Health Care	17.33%
XNJ	Industrials	- 3.82%
XIJ	Information Technology	5.50%
XMJ	Materials	- 2.28%
XSJ	Consumer Staples	1.04%
XTJ	Telecommunications	- 21.38%
XUJ	Utilities	- 10.12%
XAO	(All Ordinaries)	- 7.42%

31 DECEMBER 2018 TO 31 DECEMBER 2019		PERCENTAGE CHANGE
XDJ	Consumer Discretionary	19.14%
XEJ	Energy	18.24%
XFJ	Financials	7.39%
XHJ	Health Care	41.23%
XNJ	Industrials	22.62%
XIJ	Information Technology	31.81%
XMJ	Materials	22.09%
XSJ	Consumer Staples	17.98%
XTJ	Telecommunications	22.30%
XUJ	Utilities	10.09%
XAO	(All Ordinaries)	- 1.12%

ACTIVITY FOUR

Conduct an experiment over the next week. Imagine you've been given $10,000 to invest for one week. Choose one company and invest $10,000 (experiment A). At the same time invest roughly $2,000 in five companies from different sectors of the sharemarket (experiment B).

EXPERIMENT A: STARTING CASH $10,000 (INVEST IN ONLY ONE COMPANY)

Company	No. of shares	Day 1 price	Day 2 price	Day 3 price	Day 4 price	Day 5 price	No. of Shares X Day 5 price = $

EXPERIMENT B: STARTING CASH $10,000 (INVEST IN FIVE COMPANIES)

Company	No. of shares	Day 1 price	Day 2 price	Day 3 price	Day 4 price	Day 5 price	No. of Shares X Day 5 price = $
						Total $	

NEED HELP? To help you choose from different sectors of the sharemarket go to www.asx.com.au, locate the 'Company info page' under the navigation area 'Prices & Research'. Select 'All companies' and you will find that the industry group for each company is listed next to the share. If you click on the three letter code for that company, you can find the closing share price from the previous day to help you fill in this table.

At the end of the week calculate what your $10,000 is now worth.

Question: Were you better off diversifying?

Question: You may have made more money in experiment A by not diversifying, but explain why this might not be the right strategy to adopt in the long run.

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FLEXIBILITY

You can buy and sell shares quickly. You can sell shares and generally have access to your money in no more than three days. Other investments often take longer to sell and get your money back. This concept is known as liquidity. (Liquid investments have the benefit of greater flexibility). Bear in mind that some shares trade more actively than others. If you are concerned about being able to sell quickly and easily, look at the trading history of the shares to assess the trading volumes.

SHARE INVESTMENT - RISKS

If we say someone is volatile we usually mean they are changeable, unpredictable.

The market can go up and down quite a lot in the short term. This is referred to as market volatility.

Individual stock prices can go down as well as up. Some stocks are more volatile than others - you can usually tell this by looking at a chart of their share price movement.

It is important to monitor your shares' performance and to regularly re-evaluate whether they continue to be a good investment for you.

Some investors reduce the risk of losing money through diversification. Investors can also reduce risk by investing in certain types of shares.

Well-established companies with historically stable performance are known as blue chip companies. You may choose a blue chip company in the expectation of greater reliability or security, or consider shares in one of the more speculative stocks if you are prepared to take greater risks with your capital for the potential to make greater returns. Remember that past performance is no guarantee of future performance.

ACTIVITY FIVE

Read the first three case studies and mark on the scale below the level of risk you think each investor is prepared to take. Give reasons for your answer.

Low Risk ⟷ High Risk

Case study 1: Harry has just turned eighteen and has $5,000 to invest.

He wants to achieve a very high return and will keep his shares for at least two years.

Harry asks his adviser to recommend three companies and says that he would like to take a chance and invest in more speculative stocks. Harry's adviser suggest three stocks which promise to have potential but warns Harry of the possibility of losing some of his $5,000 nest egg.

Harry is prepared to sacrifice security for the potential of a greater return. He is not relying on the $5,000 to buy a car or go on a holiday and realises the risks involved.

Answer 1

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Case study 2: Sandy is familiar with share investment because her parents started a share portfolio for her when she was eight years old and she watched it grow.

Sandy has $10,000 to invest for one year only as she plans to use the money to carry out her dream and go overseas.

The thought of Sandy's $10,000 nest egg decreasing even slightly as a result of her shares decreasing in value makes Sandy feel nervous and worried.

Answer 2

Case study 3: Kim has just finished school and has $3,000 to invest in the sharemarket.

She learnt about the sharemarket at school and has a keen interest in developing her own portfolio while minimizing risk through careful stock selection.

Kim believes investment in good sound companies with a proven track record will help minimize risk and is prepared to invest over a five to ten year period.

While Kim has a working knowledge of the sharemarket and tries to stay informed she realises the market will fluctuate but believes her long term approach to investment will reduce the potential for risk in the end.

Answer 3

QUOTE

Alan Hull, author of personal investment books says:

"The only advantage of not having a plan is that you will never know when you've failed."

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SETTING YOUR INVESTMENT GOALS

Before investing in shares it is advisable to ask yourself a series of questions to ensure this type of investment is right for you.

- What do you want to achieve from your investments? Do you want a return in the form of income (such as dividends) or capital growth (buying shares at a lower price than you paid for them)?
- Are you prepared to risk some of your investment capital for the opportunity to make higher returns?

Your age and time frame for investing may affect your long term and short term goals.

For example, a single person with no dependants may be willing to accept more investment risk in return for higher growth. Retirees are often very concerned about not losing their savings.

It is important to identify your goals so you can plan towards achieving them.

ACTIVITY SIX

Fill in the table on the next page and discuss your short term and long term goals with your classmates. We are talking here about what you would like to own, how financially secure you want to be etc.

A short term goal may be that you wish to buy some clothes or a computer game and a long term goal may be that you wish to purchase a car by the time you are 18. It's pretty hard to imagine what your goals will be when you are 50 years old so try to put yourself in the role and perhaps think of others the same age and what they are doing. If your long term goal is to live on a tropical island and not work for the rest of your life you had better start planning now.

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	SHORT TERM GOALS	LONG TERM GOALS
Teenager – now		
When you finish school		
When you turn 21		
When you turn 30		
When you turn 40		
Middle age		
Retirement		