

Course 2: Why and how to invest

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Topic 1: Why invest?

Investing and financial freedom means something different to everybody: being able to retire at 50, setting up your own business, paying the mortgage, writing a novel or travelling the world.

To achieve your goals consider how much you will need, and then think about how you can invest your money to help you achieve these goals.

This course will look at:

- Some of the key approaches to investing
- Developing a financial plan
- Understanding the main investment areas: shares, cash, property and fixed interest.

Investing for capital growth

Capital growth occurs when the value of your investment increases. Most people invest for capital growth to build their wealth over time and protect themselves against inflation.

Investing for income

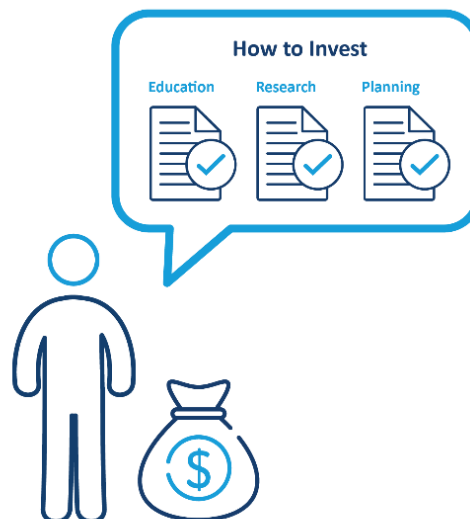
People can seek an income stream from their investments in order to supplement their primary source of income. Many retired people live off the income from their investments (e.g. dividends from shares and rent from property). Fixed interest products such as bonds and hybrids offer a potentially regular income stream.



Topic 2: How to invest

Learning how to invest is an important skill. By working through these ASX courses you are developing a base of knowledge that will help you understand how to invest and determine what might be a suitable investment for you.

Getting started in investing is just like any project, you first need to draw up a plan.



What is financial planning?

A financial plan is a strategy for meeting your financial requirements and realising your lifetime goals. It takes into account your income, expenditure, investments and liabilities over the long term. It generally involves a few key steps:

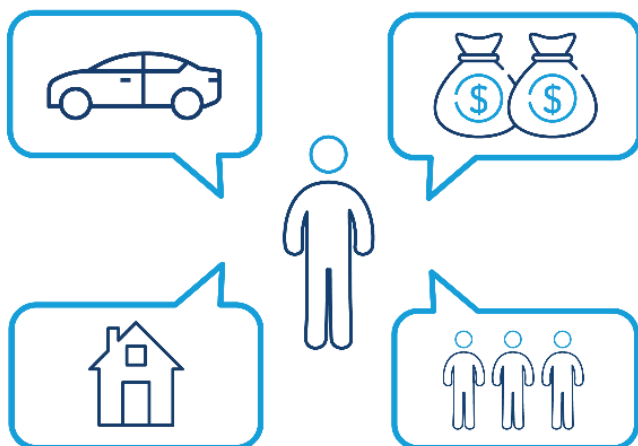
- Analyse your current financial position
- Identify the level of risk with which you are comfortable
- Regularly review the investment portfolio once it is established.

You can prepare your own plan, or pay an adviser to help you. The perspective provided by a skilled professional is often invaluable.

Let's look at some of the steps you might take when developing a financial plan.

Analyse your current financial position

Establish your needs and objectives. Needs are basic requirements such as food, rent, payment of tax, insurance and school fees. Objectives are goals that can change over a lifetime, such as tax minimisation, wealth accumulation and retirement.



Identify the level of risk you are comfortable with

Everyone has a different tolerance for risk. That is, how comfortable they are with the prospect of losing some or all of their money invested.

Your risk profile will be determined by a number of factors. Some of these are outlined below.

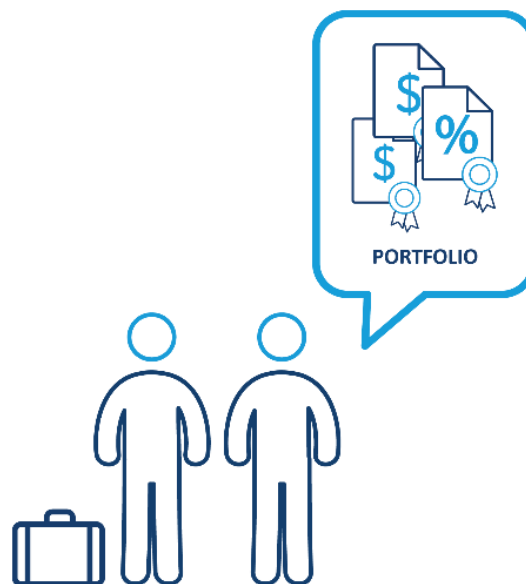
Your stage of life

If you are young, it is likely you can afford to take greater risks with a view to achieving higher returns in the longer term. If you are older, then security of capital will probably be more important, although capital -growth investments still have their place in any portfolio.

Your investment time frame

If your goals are long term, then you may be able to take the risk of short term volatility because you should have the time to ride out any market corrections (a market correction is another term used to describe a market downturn). However, if you need money for a deposit on a home, say in three years, you may need to be more cautious.

Every investor has a different risk/reward profile. Taking the time to identify your own risk/reward profile will help both you and your adviser choose the best investments for your needs.



Review your investments

Regularly review your investment portfolio once it is established. By reviewing your investments you can check to see if they are meeting your goals and act early to rectify them if they are underperforming.

Visit the course 'Record keeping' for more information on tracking your investments and keeping financial records.

Topic 3: Your investment strategy

A strategy is simply a set of rules or guidelines that are adopted consistently over time. Having a strategy does not prevent you from having losses.

A strategy may assist in investment success by providing benefits which can include:

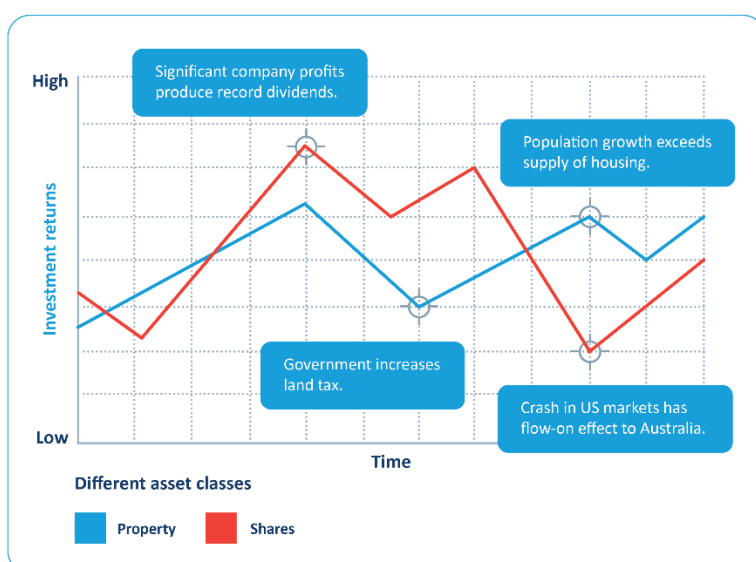
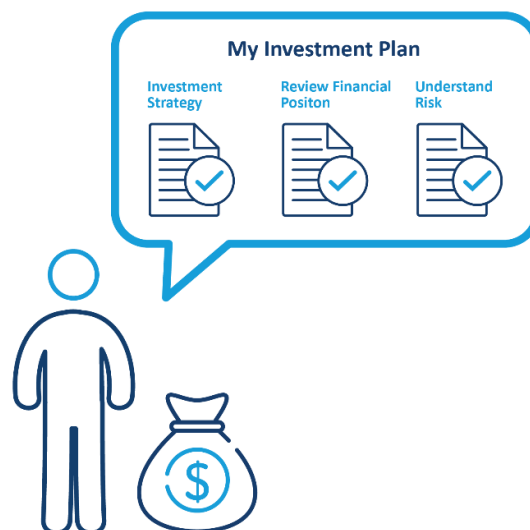
- Diversification
- An objective and consistent approach

Diversification

One of the most famous sayings about successful investing is 'don't put all your eggs in one basket'. Markets such as shares and property move in cycles. Many investors fall into the trap of putting all their money into one asset class - usually at its peak, and then watch as another asset class takes off without them ('asset class' refers to a main investment area, like shares, or property).

It is better to diversify, spreading your risk, and enjoy the upturns in markets because you are already in them, rather than trying to 'time the market'. Diversification serves to protect overall investment returns. That is, while one element of the portfolio is performing poorly, some other investment may be doing well.

Importantly, proper diversification does not simply serve to have the gain in one investment compensate for the loss in the other. Effective diversification should also see the combined total of all investments advance in value as well. Being aware that there is no investment that will do well at all times can help reinforce the need to adopt a diversified approach to investing.



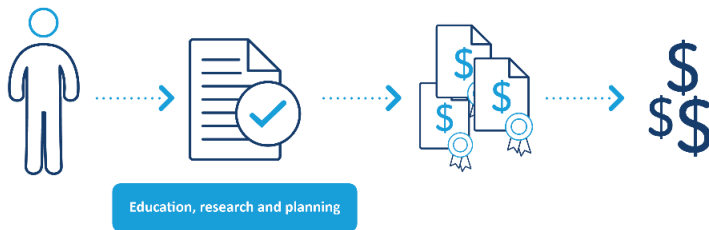
An objective and consistent approach

Investors form views about where they think the market is heading or about the value of individual shares. Some allow their emotions to override their rational analysis. Having a detailed strategy can help to counteract the chances of investing with the heart not the head.

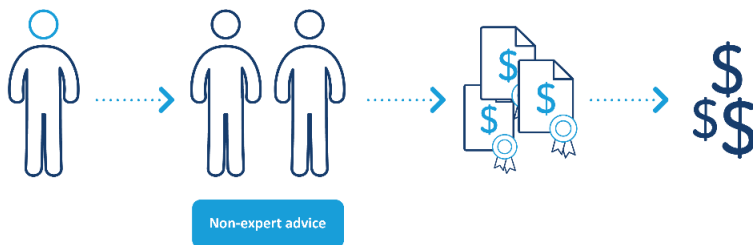
Having a documented strategy will also assist you in repeating your successes and avoiding repetition of your failures. Developing a strategy that incorporates adequate research, and monitoring elements will go a long way to providing a sound investment portfolio.

You can learn more about this in the later course 'Sharemarket investment strategies'.

Investor with a strategy

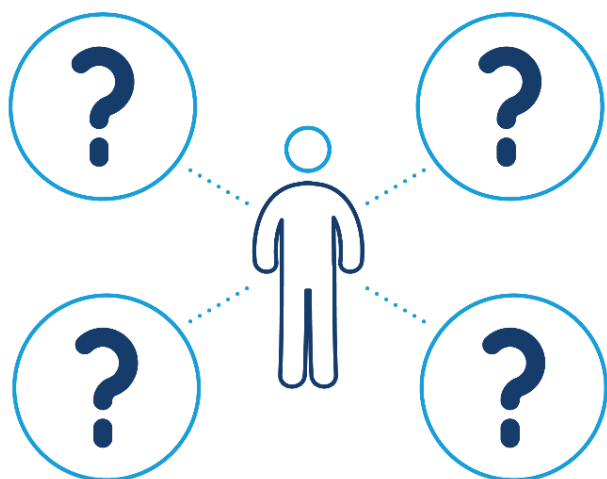


Investor without a strategy



Topic 4: The main investment areas

Financial advisers are often asked, 'Where is the best place to invest my money?' In asking such a question, their clients are hoping to be told that there is one sure bet - that shares are better than property or government bonds are the best way to increase their wealth.



Of course, depending on your personal financial goals and objectives, one particular form of investment may be better than another for a period of time. 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 their value being eroded by inflation.

There are different asset classes that each have a valid place in a diversified investment portfolio. By spreading your investments between different asset classes you are aiming to spread your investment risk and therefore smooth out your returns.

There are four main investment areas:

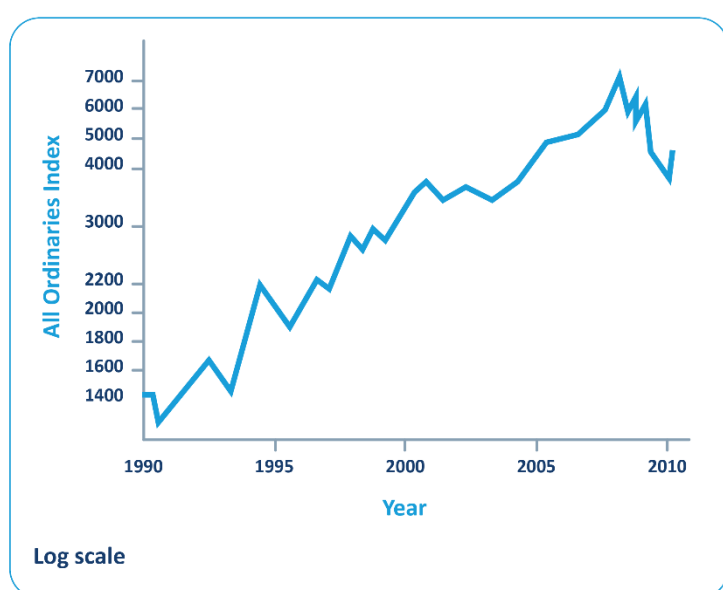


1. **Cash** - through which you invest money in a bank, building society, or other financial institution. Investment options include cash management accounts. The major benefit of this investment type is liquidity ('liquidity' refers to the ability to convert an investment into cash).

2. **Fixed interest** - through which you invest in short or long term interest rate products that provide a steady income stream. Investment options include bonds, hybrid securities, term deposits, and other types of securities. There are [fixed interest products](#) listed on ASX.
3. **Property** - through which you invest in residential, rural, industrial or commercial property. Your own home may be included in this investment class, depending on your retirement plans and financial objectives. You can also invest in [A -REITs or Real Estate Investment Trusts](#) (formerly property trusts) listed on ASX.
4. **Shares** - through which you invest in companies listed on ASX and overseas stock exchanges.

Comparing the performance of the main investment areas:

History demonstrates that shares, as a long - term investment, have the potential to provide strong returns when compared to other major investments.

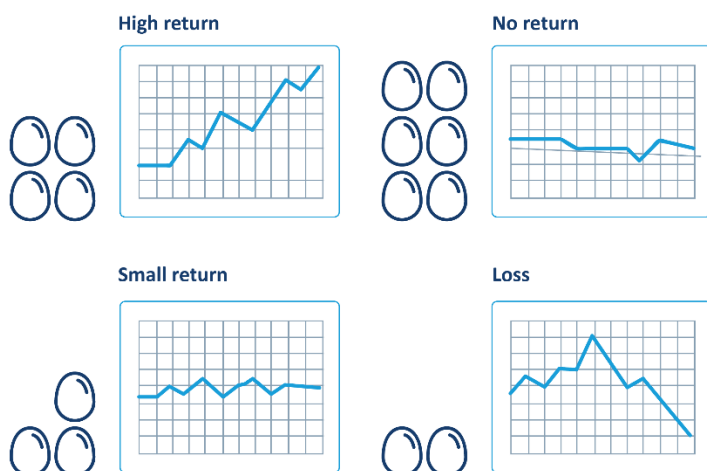


Share values have historically risen over the long -term, but this has been punctuated with periods of short -term volatility, where prices can go up or down very quickly. Many financial advisers recommend a long term view when investing in the sharemarket – between 3 -7 years.

There is a lot of merit in the saying - 'past performance is not a guarantee of future returns.' Investors should keep this in mind when reviewing information on past investment performance figures.

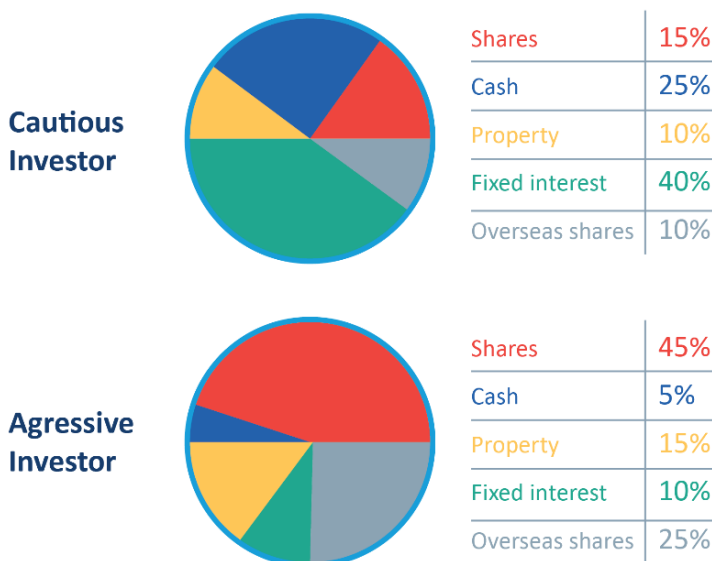
Asset allocation

Within your investment strategy you need to work out what proportion of your total capital you should invest in shares, property, fixed interest and cash. This is called asset allocation.



Each sector should be weighted in accordance with economic conditions and investment prospects. This helps to reduce volatility and risk in your portfolio. Of equal importance is the need to achieve a balance between income and growth.

Three common investor attitudes are:



Cautious investors seek better than basic returns, but insist that the risk must still be low. They seek to protect wealth that they have accumulated.

The prudent investor wants a balanced portfolio to work towards medium to long-term financial goals. They require an investment strategy that will cope with the effects of tax and inflation. Calculated risks aimed at achieving greater returns, in the form of both income and growth, are acceptable.

The aggressive investor is prepared to take greater risks in pursuit of potentially higher gains. They may take on a higher level of gearing and business risk.

Summary

- Why invest? - To help meet your financial goals
- How to invest - Develop a plan either with a professional adviser or on your own. Most importantly, assess your risk profile
- Consider your investment strategy to assist with diversification, objectivity and consistency of your investment approach
- The four main asset classes are shares, property, cash and fixed interest.