# How to start investing

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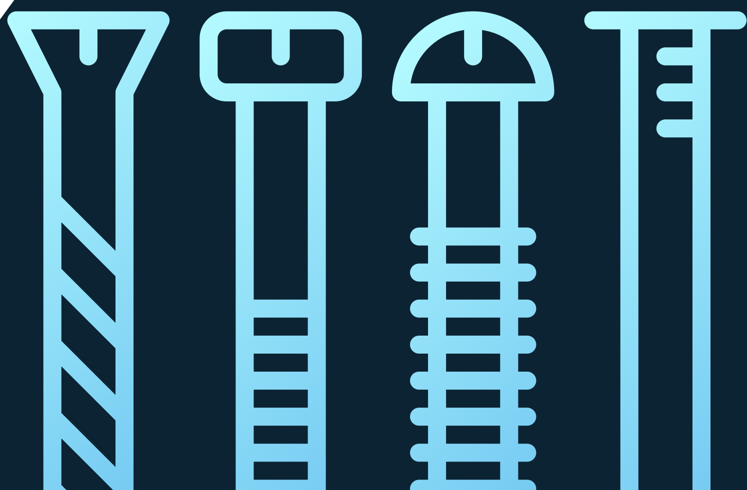
There are many ways you can invest your money. This is the first in a series of three brochures with information about investing, key considerations, platforms and resources.

In this brochure, “**How to start investing**” we will help you understand the key features of different investment options.

The second brochure, “**Ways to invest**”, looks at different platforms for investing and the importance of understanding the associated ownership structures.

The third brochure, “**Buying and selling shares and investment products on ASX**” provides guidance on how to find a reputable stockbroker, and outlines the process of buying and selling shares and investment products such as Exchange Traded Funds, as well as the costs involved in the process.



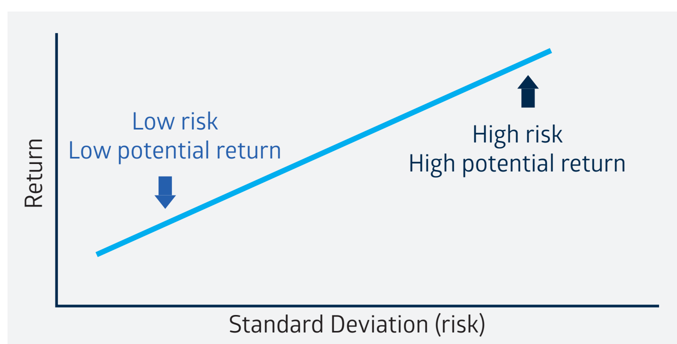
# What kind of investor are you?

Before considering different types of investments, it's important to understand what kind of investor you are. Your risk appetite may be a factor that determines your investment approach.

## The trade-off between risk and return

Every investment generally carries a risk that the investment will either provide a lower return than expected, or that the investment will lose money.

Generally, the higher the level of risk an investment has, the higher its potential long-term returns may be. The potential for higher returns needs to be assessed against the increased likelihood that the investment may not perform as expected and/or that it will be subject to price fluctuations and volatility.




Everything in life involves a certain level of risk. For example, for many people, walking is seen as less risky than riding a bicycle. By choosing the latter, you trade off a level of safety for more speed.

Recognising risk and understanding how it works is an important part of investing. Everyone has a unique risk profile that reflects their willingness to exchange risk for potential returns.

## What's your risk profile?

Your risk profile is determined by many factors, including your understanding of investments and financial markets as well as your willingness to accept a greater level of risk in exchange for the potential for higher investment returns than may be achieved under lower-risk investments. The amount of time before you need to access your funds (sometimes referred to as your 'investment horizon') may also influence your risk profile. The longer your investment horizon, the higher your risk appetite might be.

An "asset class" refers to a group of investments with similar characteristics. For example, equities and cash are each a type of asset class in which you can invest. Each asset class carries a different level of risk. Different types of investors will focus on different types of asset classes, according to their individual risk profile and investment objectives.

- A **defensive** investor is generally focused on stability and preserving their original investment. They accept a lower return for lower risk. This typically means that an investor has more of their funds invested in more stable asset classes like cash, and in fixed interest products such as bonds, rather than in riskier asset classes like equities.
- A **conservative** investor accepts a moderate amount of risk through a diversified portfolio with a small allocation to riskier asset classes like equities.
- A **moderate** investor seeks higher medium-term returns and accepts the possibility of negative returns over a short period.

- A **growth** investor is someone seeking high long-term returns and who is willing to accept a higher chance of negative returns over short periods. They may have more of their assets invested in riskier asset classes like equities and property rather than in cash and fixed interest products.
- A **high growth** investor is focused on seeking maximum long term returns through access to more volatile investment options that may have a higher likelihood of short-term capital losses.

## Diversification

Investing in a single company or industry can expose investors to extra risk if that company or industry is underperforming. As the old phrase goes, "don't put all your eggs in one basket". Diversification is an important strategy that may help with moderating the risk profile of a portfolio.

60% of investors surveyed as part of the 2020 ASX Australian Investor Study said their portfolios were diversified. On closer inspection, however, it turned out that those who claimed to be diversified only held (on average) 2.6 types of investments. This could be explained by another key finding of the study: only 30% of investors surveyed said diversification was a top three consideration when making investment decisions.

A well-balanced portfolio allows investors to spread their risk across multiple asset classes and industry sectors.

# Different products available through ASX

Investing is about more than buying and selling shares. As outlined above, there are different investment options available, and each investment option will be suited to different types of investors with different levels of experience, risk appetite and investment objectives.

Every investment carries a level of risk, so it's important to ensure the investments you make are appropriate for you, having regard to your own circumstances. Before you make any investment decisions, you should always consider obtaining independent advice from an Australian financial services licensee.

Let's look at some of the different investment products that can be bought and sold through a broker on a public market like ASX.

## Shares

When you buy a share, you are buying an ownership stake in a business. As a shareholder, you may be entitled to a portion of profits (called dividends) and you will have various rights and obligations (including the ability to vote in annual general meetings).

Shares can hold different levels of risk, depending on several factors – including the industry the company is in as well as its management.

Shares can be categorised in several ways, including by its industry but also by the size of the business. For instance, the 50 biggest companies in Australia are included in the S&P/ASX 50 index. Shares in these companies are often called "**Large Caps**"; they represent more than half of the Australian share market by market capitalisation, which refers to how much their publicly traded shares are worth. These shares are often also called blue chip stock.

"**Mid Caps**" are the next 50 biggest companies on the S&P/ASX 100. The market value of these businesses ranges between $2 -10 billion.

"**Small Caps**" cover every other company listed on the ASX. Some markets and funds break this category down further by identifying "micro-cap" and "nano-cap" companies.

When a company issues shares for sale for the first time on the **primary market**, it's called a **float** or **initial public offer (IPO)**. There are many reasons a company may list publicly, including to raise money to fund growth plans, or to give existing owners an opportunity to exit their investment. Any time a share is sold after its IPO, it is sold as part of the **secondary market**.

The economic value of owning shares in a company can be delivered to investors through any capital growth of the share as well as through any potential dividend payments made to shareholders by the company.

**Learn more about share markets and trading through the ASX online course series.**

## Exchange-Traded Funds (ETFs)

ETFs are managed funds that invest in bundles of shares and other types of securities. When you invest in an ETF, you purchase units in the ETF, which provides you with exposure to the performance of those underlying assets. It is the ETF provider who holds a direct interest in those underlying assets.

ETFs are often structured to track a specific index or benchmark, like the S&P/ASX 200, while others are built around a particular sector like tech, currency, commodities like gold – or even the investment style of the ETF's manager – such as funds with an ESG focus.

An index-tracking ETF is one way to invest in a diverse group of shares or securities without a lot of active management, which can mean lower management fees than those charged for an actively managed fund. ETFs can also give you access to investments that would otherwise be expensive or difficult to access. They are an increasingly popular diversification tool.

ETFs can (but don't always) pay regular distributions that come from dividends, interest and capital gains that are realised by the fund by selling assets in the fund. Franking credits can also be distributed by an ETF, similar to a direct holding in the shares of the companies that are held by the ETF.

An ETF's price is designed to reflect the value of its contents. This is called the net asset value (NAV).

ETFs can be bought and sold just like shares through a broker, financial adviser or online portal.

**Learn how to build a portfolio with a single trade using an ETF.**

## Listed Investment Companies (LICs) or Listed Investment Trusts (LITs)

LICs are publicly listed investment companies, and LITs are publicly listed trusts. LICs and LITs invest in a range of assets, including shares, property and bonds, among other investment assets.

You can invest in a LIC or LIT by purchasing shares or units in the relevant LIC or LIT entity through a broker, financial adviser or online platform that allows access to the markets, much like you would purchase shares in any other type of listed company. A professional investment manager actively manages the LIC or LIT by selecting and monitoring shares and other securities in the LIC.

As an investor in a LIC or LIT, you may be entitled to a portion of any profits generated from the underlying investments (called dividends or distributions).

The market price of a share or unit in a LIC or LIT typically reflects the value of the assets held by the fund. However, at different times an LIC or LIT can trade either above or below its current value, known as its net tangible assets (NTA) in the case of a LIC or net asset value (NAV) in the case of a LIT.

Because they are actively managed vehicles, LICs and LITs can have higher fees than passively managed investment options (like index tracking ETFs). LICs and LITs also have other risks that investors should understand, including the fact that they can trade a discount or a premium to their NTA.

**Independent advice from a professional adviser is always recommended before investing in a LIC or LIT.**

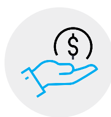
## Australian Real Estate Investment Trusts (A-REITs)

An A-REIT is an investment vehicle that owns commercial property like office buildings, shopping malls and industrial buildings. Investing in an A-REIT allows individuals to access exposure to the performance of a physical asset without requiring direct ownership of that asset.

A-REITs earn income through the increase in the value of the assets they own as well as rental income. Where distributions are made from an A-REIT, these can provide a regular income stream for investors and may offer a higher yield compared to other fixed income-generating investments like term deposits.

With higher income potential comes a higher risk. A-REITs can be affected by economic factors and market cycles like recessions. There can also be risks associated with borrowing or 'gearing' costs, which can multiply gains when a property's value rises but can also multiply losses if values decrease.

A-REITs are traded via a broker.



## Managed Funds

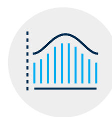
Managed funds pool money of individual investors into various investments. The investments made by a managed fund can be limited to specific asset classes like shares, bonds, property, or infrastructure, or can be a mix of all or some of them. Because managed funds tend to be actively managed, they may have fees that are higher than other investments that are subject to a passive management approach.

When you invest in a managed fund, you purchase units in the fund. Each unit represents an equal portion of the fund's value, and provide you with exposure to the performance of the underlying assets in the fund.

Income from managed funds can come from regular distribution payments out of the fund's earnings (where applicable), based on the amount of units you hold.

Unlike the investment options covered thus far, managed funds are not generally listed on ASX. Units in managed funds are often purchased by investors through a financial planner or adviser. Some fund managers allow investors to buy and sell units in selected unlisted managed funds via a broker using the mFund Settlement Service (mFunds). mFund enables you to buy and sell units in selected unlisted managed funds via the same stockbroker or adviser you use to transact shares. Your holdings in these funds are held electronically in ASX's CHESS system on the same Holder Identification Number (HIN) used to hold other investments, such as shares and ETFs.

**See how mFunds allow investors access to unlisted managed funds.**



## Other investment options

There are many other investment options available to investors that may be accessed via a broker, online platform or financial adviser.

### Bonds

**Bonds** are a type of debt security.

They are effectively an IOU between a borrower (the issuer of the bond) and a lender (the investor who purchases the bond).

When a government, corporation or other entity needs to raise funds (perhaps to finance a project or their operations), they can borrow money from investors by issuing bonds to them. Investors who purchase a bond from an issuer are essentially lending money to the issuer for a fixed period of time.

In return, investors receive the bond promising that they will receive interest payments (also called coupon payments) at certain intervals, and also that they will have their principal returned on a stated future date. The interest payments may be at a fixed rate or variable rate (also called a floating rate).

The interest rate of the bond typically reflects the credit worthiness of the issuer. Generally, the more likely a bond will be paid back at the end of its term, the lower the interest rate attached. Conversely, the higher the rate, the more likely a bond issuer is to fail to pay back that loan.

Where the bond is quoted on a securities exchange, such as ASX, the investor can realise their investment by selling that bond to another investor at the current market price.

**See how bonds work.**

### Options

An **Option** is an agreement between a buyer and seller to provide the opportunity, but not the obligation, to buy or sell a security or other asset.

Options were created as a way to reduce risk by hedging prices or setting the price that you want to pay before actually buying a share.

To access an option, a buyer pays a premium for the rights to buy or sell a specific asset upon the attainment of an expiration date, price target, or other milestone, as set out in the option contract.

**Call Options** give the buyer the right to buy an asset. **Put Options** give the option to sell an asset.

Options may also be traded on exchanges such as ASX.

**See how options work.**

### Warrants

Warrants are a form of derivative, which means they derive their value from something else, which might include:

- a share in a company listed on ASX or another exchange
- an exchange traded fund
- a share price index
- a commodity
- a currency, or
- a portfolio or basket of securities.

Some warrants give holders the right to buy or to sell an underlying instrument (such as a share) for a set price (known as **Put and Call Warrants**).

Others, such as **Index Warrants**, entitle holders to receive a cash payment based on the value of the underlying instrument at a particular time.

Some warrants have higher risk/return profiles than others. Before investing in warrants, you should make sure that you understand the risks associated with the particular warrants in which you are looking to invest.

**Learn more about warrants.**

## Your next step in investing

Once you understand the different investment options available, you may want to start looking at the available platforms for investing, and the associated holding structures, costs and other considerations that come with each platform. Read more in **Ways to Invest**.

Finding a reputable broker and getting advice is important to consider when building your investment portfolio. Learn more in our brochure Buying and selling shares and investment products on ASX.

**Want some specific guidance on learning about different options? Start with these resources from the ASX website.**

- **Online courses**
  https://www2.asx.com.au/investors/investment-tools-and-resources/online-courses
- **Investment tools and resources**
  https://www2.asx.com.au/investors/investment-tools-and-resources
- **Frequently Asked Questions**
  https://www2.asx.com.au/investors/investment-tools-and-resources/support

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