Topic 1: The risks of shares

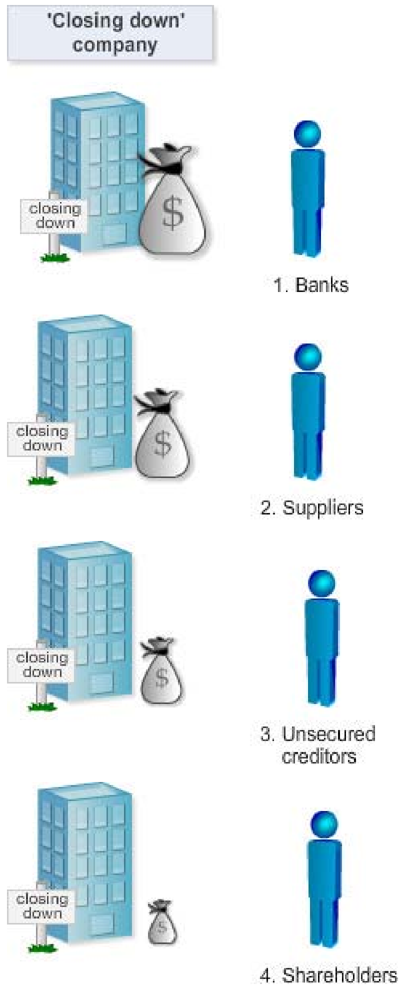
The risks of shares

Investors should be aware of the risk/reward relationship that exists with any type of investment. In order to receive a return on money invested you need to be prepared to place that money 'at risk'. Generally the greater the risk associated with an investment the greater the rate of return investors will expect.

The risk of capital loss

An investment in the sharemarket is by no means a guaranteed investment. Investors are able to redeem the value of their share investment by trading those shares via the sharemarket.

When a company is performing poorly it may be difficult to find a buyer for your shares at the price you want to sell them. As a result the sale price of your shareholding may be considerably lower than its original purchase price. What happens if you own shares in a company that fails?



In the event that the company you own shares in goes out of business, its shares will no longer be tradable on the sharemarket. When a company is removed from the list of companies whose shares are tradable on ASX that company is said to have been 'delisted'.

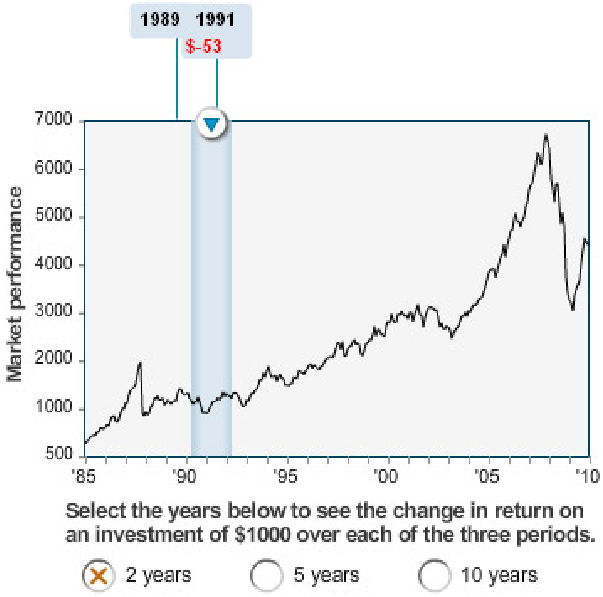
If a company you own shares in has been delisted the only way to claim back your money is if a liquidator has been appointed and shareholders receive a portion of the sale of the company's assets.

In the event of asset liquidation, shareholders are last in the list of other creditors (e.g. banks, other lenders, suppliers) to receive any funds that may be realised.

As a result shareholders may receive only a fraction of their original investment amount or could face the prospect of the complete loss of the amount they invested in the shares of that company.

Volatility risk

Share prices can rise and fall rapidly and investors must accept the fact that the value of their shares may fluctuate by as much as 50 per cent or more in a year. General market risk can relate to a particular sector, e.g. mining shares are usually more volatile than industrial shares such as bank shares. Specific risk can relate to the performance of an individual share.



Timing risk

Because of market cycles, some shares have a higher degree of risk when the overall sharemarket has risen sharply and is set for a reaction. The opposite may apply when the market has gone into a strong decline and then starts to recover after showing some signs of stabilising. Not all sectors of the market follow the same price cycles.

Understanding business cycles and how different companies perform during the different phases of the business cycle can help to manage the effects of timing risk.

The risk of poor quality advice

Are the investment recommendations made to you supported by a thoroughly argued case, or are they merely hearsay? The more reliable information you have, the better your decisions will be. Adopting a disciplined decision-making process will help you to minimise losses while you patiently build a portfolio.

Recommendations involving high rates of investment return can fail to produce satisfactory results when taxation, ongoing fees and constant changes in investment cycles affect the performance. ASIC has some excellent [information on getting financial advice on their website].

Legislative risk

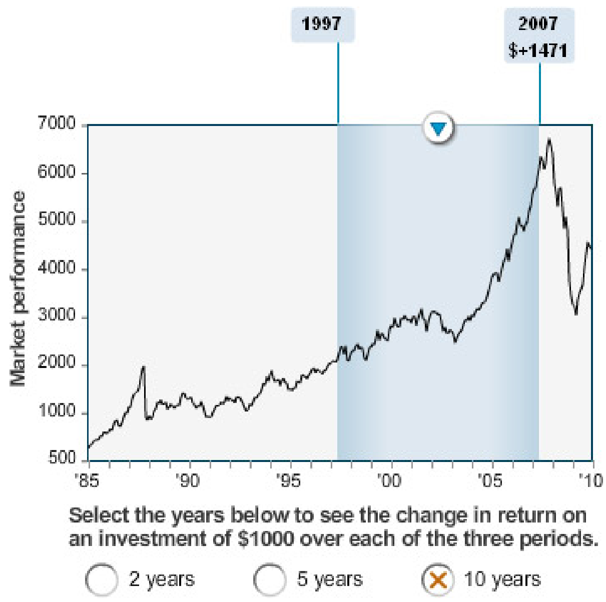
Your investment strategies or even individual investments could be affected by changes to the current laws.

Currency risk

If you have overseas investments, adverse moves in the currency need to be considered. This is because when you bring your profits home they need to be converted from the foreign currency into Australian dollars.

Time for your investments to perform

It takes time to learn to invest effectively. Time to learn about your investment alternatives, time to make investment decisions and time to manage your investments thereafter. Many people feel it is easier to invest in some areas, such as the cash market, than in other areas such as property and the sharemarket.



Depending on the amount of time you have and your level of interest, you have the choice of making all your own sharemarket investment decisions, relying more on the advice of your stockbroker or making an indirect investment through a reputable fund manager.

Of course, investment decisions become easier as you gain experience and learn more about the factors affecting your investment. These are just some of the risks that are associated with an investment in the sharemarket. Learning about risk and its effect on your investments is crucial. You should clearly understand the risks associated with any investment you are considering.

Topic 2: The benefits of shares

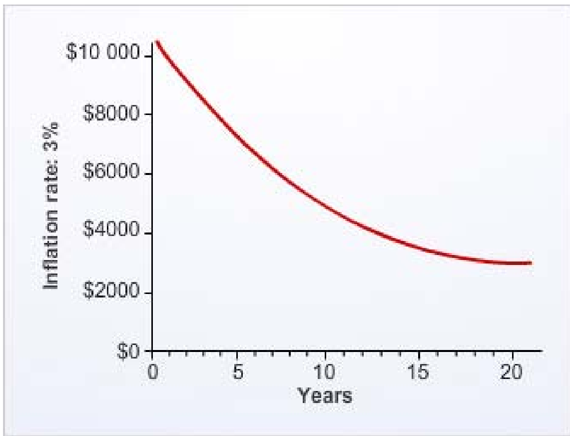
Shares for capital growth

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

People invest in shares because they offer the possibility that their price will rise. Owning shares in a company with a rising share price is one way to achieve capital growth.

Capital growth is essential to investors as long as there is inflation. Inflation is a measure of the rise in the price of goods. The [Reserve Bank of Australia](#) (RBA) aims to keep inflation within a range of 2-3%. With no capital growth, your money will buy less in the future than it does now.

The graph opposite shows the impact inflation can have on eroding the future purchasing power of money. In this example, if inflation is at 3% per annum, $10,000 will have only half its purchasing power in 10 years time.

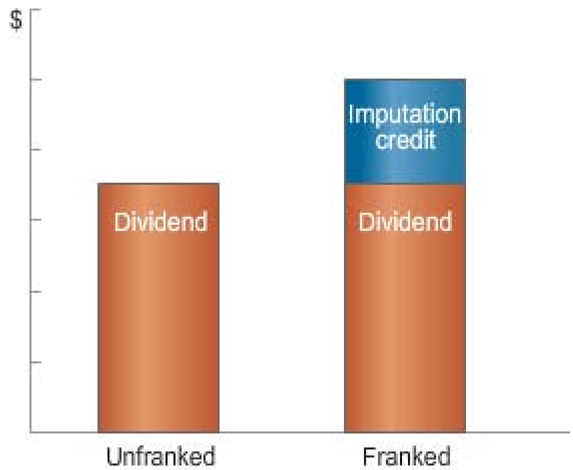


Value of $10,000 investment at 5, 10, 15 and 20 years eroded by 3% inflation			
5 years: $7299	10 years: $5327	15 years: $3888	20 years: $2838

Shares for dividend income

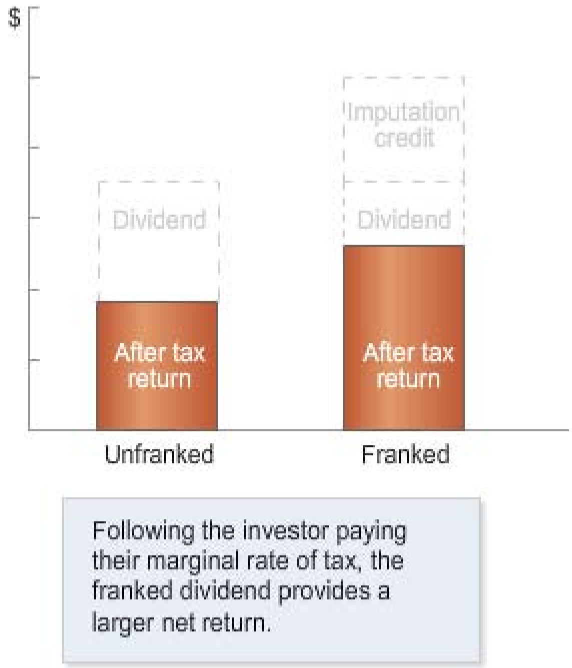
A dividend is the distribution of a company's net profit to shareholders. Dividend yields vary greatly from company to company. It is not compulsory for a company to pay a dividend.

For Australian investors, [dividends](#) are often worth more than the cash payment they receive. This is because a company can also distribute franking credits for any company tax it has paid.



Franked dividend receives imputation credit, "grossing-up" the dividend amount.

Franked dividends carry imputation credits, which entitle shareholders to a tax offset or a reduction in the amount of tax to be paid. If your marginal rate of tax is lower than the company tax rate, the excess franking rebate can be used to reduce the tax payable on other sources of income.



In addition to rising share prices, dividend re-investment plans (DRP) can multiply the capital growth effect of a share investment. DRP is an alternative to cash dividends, allowing shareholders to purchase new shares instead of receiving a cash dividend. These shares are often issued at a discount to the current market price and no brokerage is paid.

Capital Gains Tax (CGT)

Shares enjoy good taxation benefits in comparison to most other investments. You realise a capital gain whenever you sell shares and the consideration received (sale price less related costs such as brokerage) is more than the cost base (purchase price plus related costs).

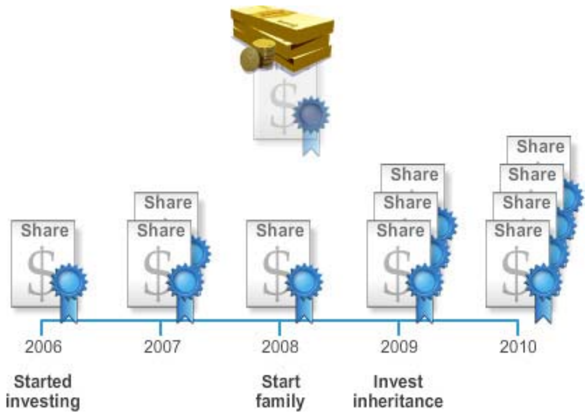
If the shares were acquired on or after 20 September 1985, the capital gain must be included as assessable income in your tax return and is subject to CGT. CGT is payable at your marginal tax rate in the year in which you sell the shares.

For shares acquired on or after 21 September 1999 and sold 12 months or more after the date of acquisition, capital gains may be discounted by 50%; meaning only half of the capital gains must be included in your assessable income.

The Australian Tax Office (ATO) is the source of knowledge for all tax related matters. For the most up to date tax information, please visit their website www.ato.gov.au

Financial control

Shares' flexibility and liquidity are key advantages. In particular, the ease and low cost involved in buying and selling relatively small amounts and the control that gives you; whether to free up some cash, rebalance your portfolio or simply realise a profit.



Many people appreciate how easy it is to invest in shares. There is no conveyancing cost, stamp duty or ongoing expenses. You can do everything over the internet if you wish, and brokerage fees are much lower than typical real estate agent fees. So you can start small, buying companies you know, and take the time to learn as you go.

We will look more closely at the process of buying shares in the course, 'How to buy and sell shares'.

Summary

- Shares present risks and benefits.
- The chief risks being capital loss, price volatility and no guarantee of dividends.
- Benefits of shares include the opportunity for capital growth, dividend income, flexibility and control.

Topic 3: Why share prices go up and down

The price of anything that can be bought or sold is unpredictable to some extent. Many factors can simultaneously affect values both positively and negatively over different periods of time. However, the impact of many individual factors is sometimes quite predictable so it can pay to consider them since that is what many other investors will be doing.

You should think in terms of factors that affect each of the following:

- Supply of and demand for the shares
- The inherent value of the shares
- Other less direct influences on share prices.

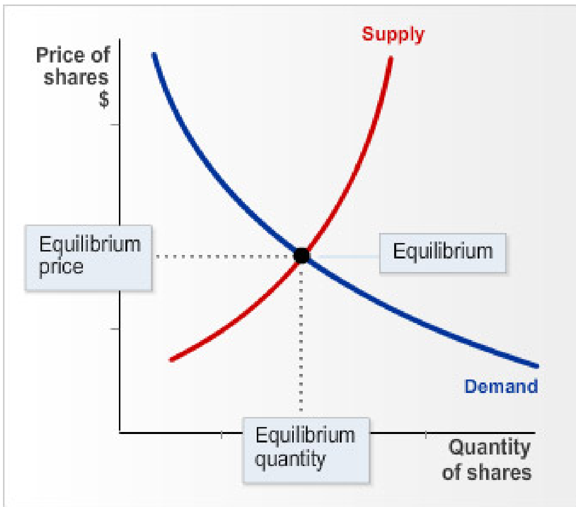
Supply and demand

The sharemarket is a market place like any other. The forces of supply and demand determine the price of shares. The more people want to get hold of a particular share, the higher its price will go. If people no longer want a share and few people are willing to buy it, people may have to offer it at a very low price in order to sell it.

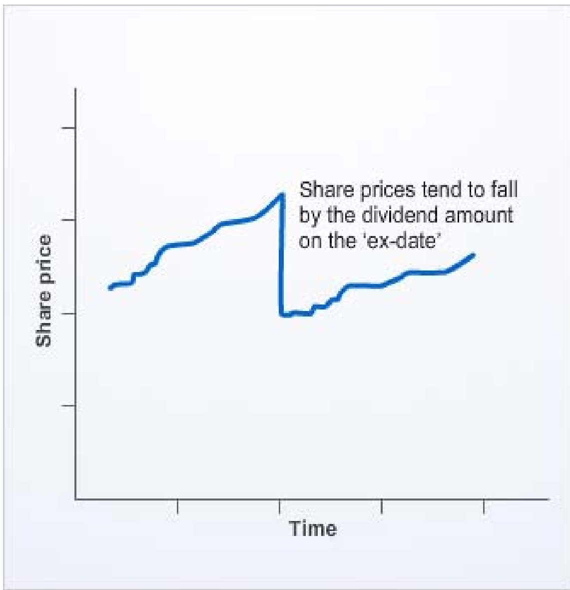
Supply and demand for shares is influenced by some of the factors outlined below.

Inherent value of a dividend

Dividends provide immediate and concrete value to shareholders so a share that pays dividends has inherent value. For this reason, the price of a share will often fall by approximately the dividend amount when the share goes ex-dividend (Ex-dividend date: Shares are quoted 'ex-dividend' four business days before the company's record date, and will remain 'ex' for five business days. Normally to be entitled to a dividend a shareholder must have purchased shares before the ex-dividend date (or buy them cum after the ex)). A share that offers a strong likelihood of capital growth due to reinvesting company profits also has a certain amount of inherent value.



Price is determined by the interaction of people looking to buy and people looking to sell

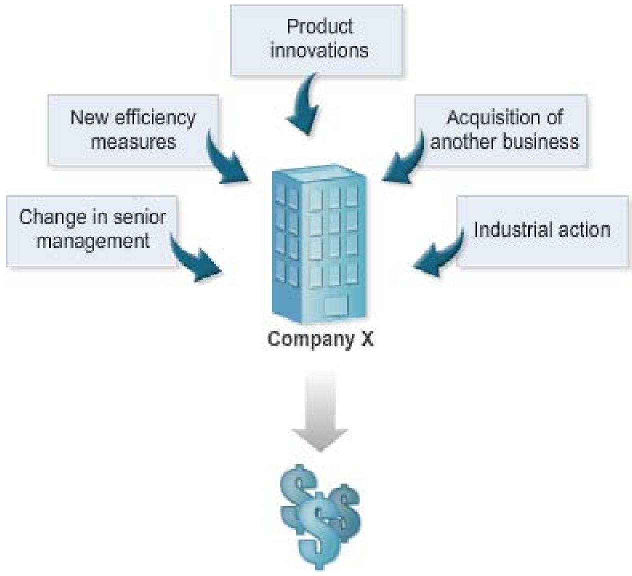


You should assess a company's ability to pay dividends or provide capital growth in the future; in particular, what are its expectations of future earnings?

You can read more about ex and cum status on the status notes page on the ASX website.

Inherent value of future earnings

The most important factor affecting the price of a share is the company's future earnings prospects, as its earnings will determine the future inherent value of a share. Any changes in forecast earnings, either by company management or by market analysts, will impact the share price.

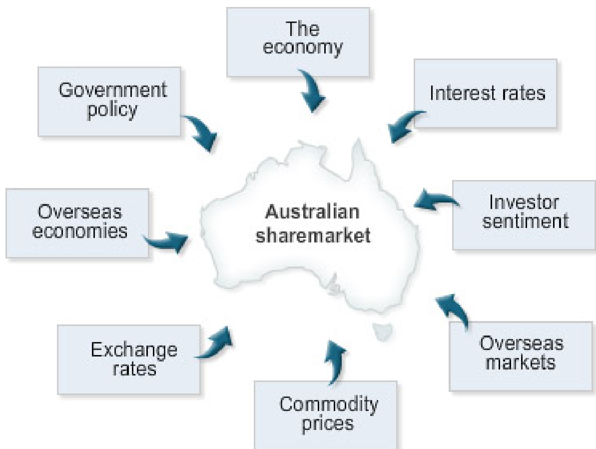


Past earnings, as can be found in the company's annual report, are an important indicator of a company's earnings ability, but you should also consider the impact of any changes to its business.

For example, how will it be affected by a change in senior management, new efficiency measures, product innovations, industrial action or the acquisition of another business?

Other factors

A range of economic factors both in Australia and overseas affect share prices. In assessing these factors you should avoid getting caught up in the short-term reaction to announcements of economic data (or short-term market volatility) but instead think of the direction of price trends and whether prices might be expected to turn around.



Australian share prices are affected by the following Australian economic factors:

- Overall economic growth (prefer steady or strong)
- Level of unemployment (prefer low but not too low or wages will rise – excessive wages growth can trigger inflation)

- Consumer confidence (prefer high as long as borrowing is not out of control)
- Spending (by consumers, businesses and governments can boost profits)
- Inflation (high retail prices can dampen the economy), and
- The value of the Australian dollar (affects individual companies differently: a rising currency can benefit importers but disadvantage exporters).

Because Australia is part of the global economy, Australian share prices are also affected by economic conditions overseas. Movements on overseas exchanges can have flow on effects to our domestic market.

This is a result of Australian company reliance on overseas markets for a portion of their profits. The globalised economy allows the funds of overseas (and Australian) investors to flow rapidly into and out of the Australian sharemarket as conditions change.

Company announcements

Keeping up to date with the information about a company you have shares in is very important. Company announcements are the main communication channel between listed companies and the market. Company announcements are notices sent electronically to ASX and published live on the ASX website.

ASX listed companies are obliged to inform the market of their activities, especially any information that might have a material effect on the company's share price.

A company announcement marked with a red exclamation indicates that the announcement is "price sensitive". In this case trading in that company's shares will be put on hold for a minimum of 10 minutes to allow investors to read and digest the contents of the announcement.

ASX Code	Published	Price sens.	Headline
CSL	2:21 PM		Appendix 3B
COI	2:20 PM		STX ann: Rocky Mountains Leaseh...
STX	2:20 PM		Rocky Mountains Leasehold Acquisition
ARU	2:19 PM	!	Response to ASX Query
BCY	2:18 PM		Disclosure Document
WAT	2:16 PM		Ceasing to be a substantial holder from...
LCP	2:16 PM		Ceasing to be a substantial holder for ...
BCA	2:15 PM		Change of Name
OTL	2:13 PM	!	Replacement & Second Supplementary...
CBA	2:11 PM		Instalment Warrant - ANZIYG Dividend...
HST	2:10 PM		Results of 2009 AGM
MFS	2:09 PM		Appendix 3B
ARU	2:04 PM	!	Drilling Commenced at Mt Porter Gold...
CFX	2:04 PM		Update from CFSPM - Resignation Ge...
MLB	2:04 PM		Change of Director's Interest Notice
UBS	2:00 PM		ISS series Final Reset details due 23...
UBS	2:00 PM		ISH Series Final Reset details due 23...
PTR	1:58 PM	!	News Rel: Asia Pacific Partnership B...
SHC	1:54 PM	!	Results of AGM

Summary

- Any investment in the sharemarket carries a degree of risk. It is possible to make a complete loss of capital with any investment.
- Carefully consider the range of risks that an investment in the sharemarket can present including market risk, poor advice, timing risk, currency risk with overseas investments.
- People invest in the sharemarket to achieve certain financial goals, most commonly, capital growth and dividend income.
- Consider the benefits of concessional capital gains tax and franked dividends when assessing an investment in the sharemarket.
- Share prices are determined by the forces of supply and demand.
- The price you see in the market is the last traded price and it is where the buyer and seller of shares have come together and agreed on a price.
- There are a wide range of factors that drive investor demand for a share. These can include the company's profitability, how its competitors are performing, any legislation that government may introduce, how overseas demand for its products may evolve.
- It is important to learn about both the broad economy and the specific company you are investing in.
- You can learn more about a company by reading the Company Announcements it releases on the ASX website.