A Beginners Guide to Investing in the Share Market

Introduction

To many people, investing seems too complicated, too difficult, or just too risky.
They are confused by the massive amount of information available, the many different types of investments and the countless opinions presented by so called market experts.

In producing this CD, our primary objective is to provide individual investors with sufficient information to enable them to make informed investment decisions.
This CD, together with the accompanying training modules, are designed to introduce you to the stock market and outline some investment strategies that will enable you to consider whether or not to invest some of your money in shares. You will learn essential concepts of investing such as the characteristics of top performing stocks and how to identify those stocks, and the correct time to buy and sell stocks to maximise gains and minimise losses.

There are many different ways for you to invest your money. Some are more risky than others. Some involve having your money tied up for a long time, others promise quick short-term gain. Not everyone will wish to invest his or her money in the same way.
However, investing in shares is one of the more stable forms of investment available, whether you are after a short, medium or long-term investment.

After viewing this CD and the accompanying training modules you will have a good idea of how the share market works and how to invest in shares that suit your particular needs. Whether you act on this information is, of course, entirely up to you.

Four Simple Rules to Financial Independence

Let's assume that you are completing this training program because you want to increase your wealth and you want to achieve financial independence through investing in the share market.

It's true that many investors have become wealthy by investing wisely in the share market, but it is necessary for you understand some basic investment principals before investing in shares.

Don't be fooled by the simplicity of the statement that there are four simple rules that if followed will lead you to financial independence, because if you follow these rules you will be well on the way to financial independence.

1. Spend less than you earn

This maxim may seem obvious but many people have difficulty following it. If you're spending more than you earn, you will never be able to become financially independent. You will be paying money to others for the rest of your life. The earlier you start living by this rule, the better, but it is never too late.

2. Save 10% of your income and invest it wisely

It may surprise you but the average Australian, earning between $30,000 and $50,000 a year for 40 years, will earn somewhere between $1,200,000 and $2,000,000 during their working life. Yet most of them will retire poor.

Saving just 10% of this along the way would provide a nest egg of $120,000 to $200,000 that could be used as the basis for an investment program. So the level of your income has no

bearing on the level of wealth you achieve, what is critical is the amount you save.

Many studies have shown that a sensible and knowledgeable private investor can expect their investment portfolio to out perform those of many professional fund managers. That is because the individual investor has flexibility, agility and low overheads.

3. Develop an investment plan and allow your investments to grow
'If you fail to plan…. you plan to fail'.

If you want to achieve your investment goals, whatever they are, it is critical to develop an investment plan. Then you must adhere to the plan and only change when there are significant changes in the basic factors. Ideally, leave your investment alone and let the magic of compounding do its work.
But start now!

On average, people need about 75 percent of their pre-retirement income to maintain their standard of living throughout their retirement. That translates into consistently saving about 10 percent of your income throughout your working years.

The longer you wait though, the harder it gets. Every decade you put off saving nearly doubles the amount you have to save to meet your retirement goals. For example, if you need to save 5 percent a year starting in your early 20s to attain retirement bliss, you'll need to scrimp and save 10 percent annually if you wait until your 30's to start saving. And if you wait until your 40, the amount jumps again to 20 percent.

4. Understand the Power Of Compounding
The principle of compounding suggests that even a small sum of money can grow into a huge investment over time. It has been said that when Albert Einstein was asked "What is the most powerful force in the universe?" he replied "the power of compounding!"

What this means to you is that if you invest, even a small amount, in an asset that grows in value over time, and you reinvest the income from your investment (the interest you receive, or the rent you receive from your property investment, or the dividend you receive from your shares), the magic of compounding will work miracles for you.

It also means that you can no longer use the argument " I can only save $5 a week, so it's no use. It will never amount to much." Even small regular savings compound to large sums over the years.

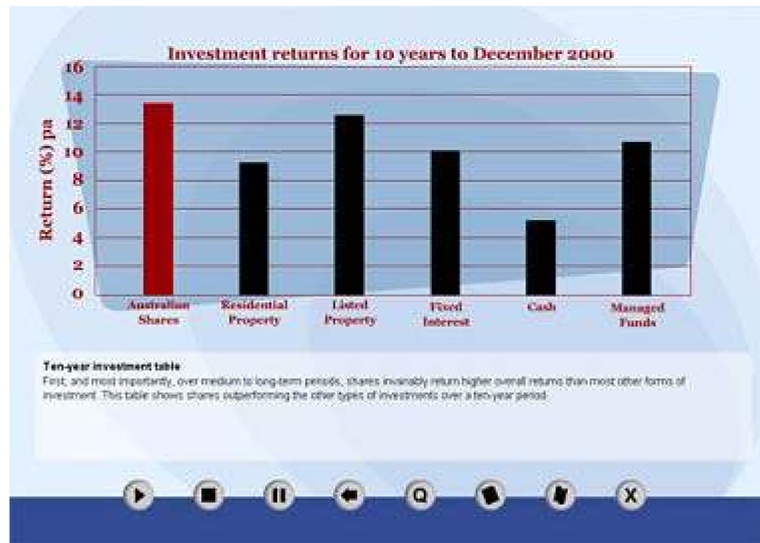
Why Invest in Shares?

Although there are many options available in which to invest your money, few of them offer the same security and likelihood of consistent profits than the share market. However, other investment options do offer some advantages over shares.

Fixed interest offers security. Cash offers liquidity. Property investors can directly increase the value of their investment by renovating, extending or even knocking down the property and rebuilding. It is also easier to borrow money against a property than it is against shares. Overall though, there are many reasons for shares to be considered above other options.

Ten-year investment table
First, and most importantly, over medium to long-term periods, shares invariably return higher overall returns than most other forms of investment. The table shows shares outperforming the

other types of investments over a ten-year period.



Report compiled by Towers Perrin for the Australian Stock Exchange in September, 2001

This result is not confined to this particular period. Throughout this century, shares have returned greater profits, more consistently, than the other forms of investment. These returns can be delivered in one of four ways: the initial dividend yield, increasing dividends, tax benefits and increased share value.

Initial dividend yields

The initial dividend yield is the share of its profits that a company pays to its shareholders. The dividend is generally paid every six months. Not all of the company's profits are paid in dividends. A company's board of directors will usually decide how much of the profit should be distributed back to the shareholders and how much should be ploughed back into the business to increase further the company's worth. In some cases, the board may decide to re-invest the entire profit.

Increasing dividends

Increasing dividends are paid out by well-performing companies that experience an annual increase in profits over a number of years. They are in a position to be able to increase their dividend payout so that it consistently keeps pace with or outstrips inflation.

Tax benefits

Tax benefits from shareholdings are available because many companies pay tax on their profits, meaning investors receive tax credits on the dividends they receive. Often, shareholders pay little or no tax on the dividends they receive.

Increased share value

Increased share value occurs as the value of individual shares increases, resulting in an overall increase in an investor's portfolio. However, the increased share value only has a paper worth unless the shareholder decides to sell some or all of the stock.

Shares are a liquid investment

Apart from their consistent performance, there are other reasons why shares are an attractive investment option. They are a liquid investment. That is, they can be bought and sold as required. Selling a property can take months. Selling a share can take seconds. Shareholders can choose to divest themselves of just a portion of their holdings in a particular company, or they can sell the lot. Such an option is not available with property.

It is easy to ascertain the true value of shares

Another advantage is that the true value of a share investment can easily be ascertained. It is as simple as looking up the daily share market results in the newspaper or on your computer. If only it was that easy to value a property.

Diversification

Creating a share portfolio enables you to invest in a number of industry sectors. By investing in companies operating in different industry sectors, you minimise losses from one badly performing sector. As one sector suffers a downturn, another may be experiencing growth. This is one of the major reasons that a well-balanced share portfolio invariably outperforms many other types of investments.

What is the Stock Market?

The Australian Stock Exchange

So what is the stock market and what are shares?
The stock market is where the buying and selling of company shares takes place. In Australia, these transactions take place through the Australian Stock Exchange, or ASX as it is known. It was formed in 1987 by amalgamating the six capital city stock exchanges. The amalgamation was necessary because of financial deregulation and the accompanying increase in international transactions.

Before 1987, most of the action took place on the floor of the stock exchanges. Transactions were shouted, prices were chalked up on a board, in fact, to most of us, it seemed as if there was little order to the goings-on. However, the ASX introduced the Stock Exchange Automated Trading System (SEATS), which by 1990 had taken over all transactions. SEATS allows trading to be conducted through a computer system. Transactions are processed in the order in which they are made and the system links buyers and sellers. It may not match the drama of the past but it is far more efficient.

S&P/ASX 200 Composite Index

The state of the stock market is judged by the S&P/ASX 200 Composite Index, which recently replaced the All Ordinaries Index, formerly known as the All Ords.

The S&P/ASX 200 Composite Index is a measure of 200 of the largest and most frequently traded stocks on the Australian share market. Measuring their rise and fall allows us to have a fairly accurate reading of how the Australian market as a whole is faring.

The American equivalent of the S&P/ASX 200 Composite Index is the Dow Jones Index. Each major share market around the world has its own index to help investors rate how the market is faring, plus a number of sub indices such as the industrial index, a gold index or a resources index, that measure particular sectors.

What are Shares?

When you buy shares in a company, you are buying a share of the ownership in the underlying company, complete with the right to a share in the firm's future earnings. The more shares you buy, the more of the company you own.

So why does a company issue shares? Well, usually a company will issue shares when it needs to raise capital (money) for expansion, research and development, for its general operations or to pay off debt. The company could also use other options such as getting a loan from a bank or issuing bonds or debentures. One of the advantages of issuing shares is that shares raise capital without debt and without a legal obligation to repay the funds, unlike bank loans or bonds, which are direct debt obligations of the issuing corporation.

The first time a company sells stock to the public it is known as a Public Float or Offering, or sometimes referred to as 'going public'. There are thousands of publicly listed companies you can purchase shares in, from a diverse range of sectors.
There are also different types of shares.

1. Ordinary shares

The most common type of shares are known as ordinary shares. Purchasing ordinary shares gives the owner a stake in the company and an entitlement to dividends. Dividends are the part of the company's profits that are paid out to the shareholders every six months when the company is making a profit. Most ordinary shares also give the shareholder a right to attend the company's annual general meeting and vote on issues relevant to the company's future.

2. Preference shares

Preference shares return a fixed dividend to the investor that is not linked to the company's annual profit result. Although preference shareholders receive dividends before ordinary shareholders, they do not receive the same voting rights as ordinary shareholders.

3. Contributing shares

Contributing shares are those that have not been fully paid for and require further payment in the future. Dividends are generally paid according to the proportion of the paid-up amount.

4. Bonus issues

A bonus issue is a free issue of new shares to existing shareholders. Every now and then when a company makes an extraordinary profit, or if it has amassed accumulated profits over a period of time, it gives its shareholders a present of a bonus issue of shares at no cost. Receiving a bonus issue does not increase the proportion of a company owned by the shareholder, as all shareholders receive the same present in proportion to their ownership of the company. It is, in effect, a cashless dividend.

5. Rights Issues

A rights issue is also an issue of new shares to existing shareholders. However, these are not free. A rights issue occurs when a company needs to raise extra capital and it gives its shareholders a right, but not an obligation to purchase extra shares. There are two types of rights issues, renounceable and non-renounceable rights. Renounceable rights can be traded on the share market if an existing shareholder does not wish to purchase the new shares being offered to them. They are therefore of some value to the shareholder - a little bonus. Non-renounceable rights cannot be traded or sold to others, so if the shareholder does not take up their right to buy the new shares by a particular

date, the rights are of no value to them.

So those are the five main types of shares. In general, when we refer to shares in this and other training modules, we are talking about ordinary shares.

Why Share Prices Go Up and Down

If you didn't know better, you might think the share market had a mind of its own. Simply watch the share prices for a week and chances are you'll see them drop or rise sometimes by dramatic amounts. Trying to make sense of those shifts might seem difficult, but closer examination reveals that definite forces shape share prices. Share analysts make their living charting these forces and the effect they have on companies, industries and national economies. An understanding of these forces can do more than help you formulate an investment strategy - it will also help you see how events can shape everything from the unemployment rate to interest rates.

The price of a company's share is directly linked to the fortunes of that company or, to be exact, the perceived fortunes of that company. That is, what share investors think will happen to the profitability of the company. When a company is experiencing high profits the share price will generally increase as more people want to buy a share of the company and share in its success.

Similarly, as a company's profits decline, the share price will probably fall, as existing shareholders sell their stock, perhaps to move their investment to a more profitable company. Obviously, it is better to buy your shares when the price is lower, rather than when share prices increase. Buy low and sell high is the general rule.
Following are a few of the factors that affect the price of a share:

- Supply and demand
- A company's financial health
- The industry's financial health
- Economic trends

Supply and Demand

There's an old saying that a share is only worth what somebody is willing to pay for it. And that's true - buyers determine the price of a share. As investors gain new information, they decide how much they are willing to pay for a share. Their changing perceptions cause share prices to rise or fall. The price of a share is no different to any other product or service. It is determined by supply and demand.

The supply of shares is based on the number of shares a company has issued, or sold to the public. The more that people desire to own a share, the more they are willing to pay for it. High demand for a share pushes up its price. Then as the value of a share increases, owners are more reluctant to sell it. The rise continues until prospective buyers decide the price has gone too high. Then fewer people are willing to buy the share at the high price. Shareowners who are anxious to sell must then lower the price at which they are willing to sell and the share's price falls until investors believe the share is again worth the price at which owners are willing to sell.

A Company’s Financial Health

The laws of supply and demand explain why share prices fluctuate. But how do investors and analysts arrive at their decisions as to whether a share is worth buying or selling at a given price? People invest in shares to make a profit. This profit comes in part from the dividends that the company distributes to its shareholders (their share of the profits of the company) and partly from the increased value of the share. So when assessing the value of shares in a particular company it is critical to examine the financial health of the company.

Investors are not likely to put a high value on shares in a company that is going to lose money. They look for a business with a history of making strong profits and consistently paying healthy dividends.

Investors also analyse the company's future prospects. A company with a poor history may well be set for a promising future, and one with a good history might be on the way down. Careful investors also review how a company fares against its competition and whether it is being run by experienced, responsible people who keep up with current trends. If a company is viewed by potential investors as likely to increase its efficiency or if it produces new, innovative products, its share price is likely to rise.

Alternatively, trouble on the horizon such as more intense competition, decrease in demand for its products, damaging lawsuits or threats of industrial action can depress the value of a company's share.

The report of a potential takeover, that is when another company is trying to buy some or all of the shares in the company, usually forces up the price of shares in the company. This is because the purchaser has to buy a majority of the shares to gain control of the company and to do so the suitor must persuade shareholders to sell their share by offering an attractive price for their shares.

The Industry's Financial Health

A company's share price may go up or down depending on whether investors think that its industry sector as a whole is about to expand or contract. It is well recognised that many industries expand and contract in cycles.

For example, the building industry is cyclical and very dependant on interest rates. Even if a particular building company may be doing very well financially, and have plenty of orders on its books, if the building industry in general is declining, for example when interest rates rise, investors might question the company's ability to keep growing. In that case, the company’s share price may fall.

Economic Trends

In addition to events surrounding a specific industry or company, analysts carefully watch what they call economic indicators - general trends that signal changes in the economy. The three major ones that influence the price of shares are Gross Domestic Product, currencies and interest rates.

Gross Domestic Product

GDP is the rate of economic growth of the country as measured by the total production of goods and services in our economy. When the GDP is rising and the economy is growing, short-term business prospects tend to improve.

Currencies

Another important factor is the demand for a countries currency. Generally, when a countries economy is buoyant we see a strengthening in a countries currency, which in turn increases the price of exported items. However, when a countries economy is contracting, business activity is generally slows and we see a softening in demand for a countries currency, which in turn reduces the costs of exports.

Interest Rates

Interest rates measure the cost of money borrowed by the government, businesses and consumers. Rising interest rates mean that it costs a company more to borrow and run its business and this can lead to lower profits.

Monitoring the Price of Shares

You can check the daily share prices in the business section of most daily newspapers. Usually the following prices will be quoted:

The ***Closing Price***, which is the last trading price recorded at the close of the market.
The day's ***Price High***, being the highest price paid for the share over the last trading day.
The day's ***Low***, being the lowest price paid for the share over the last trading day.
The ***Price Change***, which compares the stock's closing price with the previous day's close.

A (+), (-), or (...) preceding the figure indicates that the stock has increased, decreased, or remains unchanged from the previous day's closing price.

Making an Investment Plan

We are all used to making plans. We make them every day, at work and at home. Making a shopping list is a plan. So is organising a holiday. Setting agendas for meetings and ranking the importance of tasks at work are examples of planning. How to arrange your finances is one of the most important decisions you have to make. So make sure you sit down and plan carefully. It is useful to develop an investment plan that you adhere to, and only change when there are significant changes in the basic factors.

In general when making your investment plan, you should aim at developing a diversified investment portfolio consisting of shares, some property and some fixed interest investments. By not having all your eggs in one basket, you will maximise returns and minimise the risks that occur during the various parts of the economic cycle.

Obviously when you start investing, you cannot invest in all of these sectors at once. If the timing in the economic cycle is right, starting with some shares as your first investment often makes sense. You can begin investing in some shares with as little as a few thousand dollars, compared with the large amounts of money required for the deposit of an investment property.

If you have a long-term preference for property investments but do not have enough funds available to enter this market, investing in shares could prove a profitable short or mid-term alternative. The relatively liquid nature of shares enables you to exit the share market easily when required, in this case when adequate funds to enter the property market have been accrued.

Whether you are looking at investing in shares in the short, medium or long-term, the shares that you purchase will depend on your individual circumstances. As no two people are alike,

share portfolios should be tailored to an individual's needs. Your investment plan will depend on several factors: your age, income level, the need for liquid assets, attitude to risk taking and taxation situation. All of these factors should be considered when you formulate your investment plan.

- Age
- Increased share value vs. regular dividends
- Income level
- Need for liquid assets
- Attitude to risk taking
- Taxation situation
- Checklist

Age

As far as age is concerned, in general older investors seek security while younger investors can afford to take a few more risks. This is because older investors are unlikely to be able to top up their portfolio if any of their investments perform poorly. Younger investors can take more risks, partly because they may be able to afford to sit on their shares through a downturn and wait for their value to increase again, and because they have a continuing capacity to earn if their investments turn sour.

Some experts recommend a formula that tells you what percentage of your long-term investment money should be invested in aggressive growth vehicles such as shares.
That means no lying about your age to look younger! For this formula to work, you can't be one of those people who are perpetually twenty-nine years old.
And the formula is, simply one hundred minus your age equals the percent of your investment money that should be in aggressive growth investments.
This formula is really straightforward and makes logical sense.

When you're young, you have time on your side. If one of your investments is unsuccessful, it may be upsetting at first. However, you have many years before your retirement to rebuild your wealth before you actually need to touch the money.

And the formula works so that when you grow older, more of your assets should be invested into conservative, income-producing investments such as bonds. That's because when you're 50 years old you have a lot less time in the job market to rebuild your retirement fortune than when you're a spry twenty-five year old.

This formula generally applies to money earmarked for retirement. Or at least money that you won't touch for ten years or more.

Increased Share Value vs. Regular Dividends

These differing circumstances highlight one of the main questions you should ask yourself when considering which shares to buy. Are you seeking increased share value (capital gains) or regular dividends? That is, do you want your shares to increase in value so that you can sell them and make a profit or would you prefer to be paid regular dividends that are greater than the cost of living?

Clearly, older investors should weigh their portfolio heavily towards the security of well-established companies with a record of paying regular dividends. Though younger investors

should also consider including some of these companies in their portfolio, they have the option of including several companies that may experience rapid growth in the forthcoming years. These companies may not pay dividends, preferring to re-invest profits into the company, but a rising share price will enable the investor to realise a profit.

Income Level

A similar scenario applies to income level. Investors who have little other income apart from their share portfolio will be looking to invest in companies that offer security and regular dividends. For those whose stock investments represent only a portion of their income, more diverse investments are possible.

Need for Liquid Assets

Another thing to think about is whether you will require some of your funds in the near future. You may want to buy a house or travel overseas. If that is the case, you should carefully consider the shares you choose, as well as how much you wish to invest in the share market in the first place.

Although the market has proven to return higher profits over time than most other secure forms of investment, the market does experience peaks and troughs. If you enter the market at the wrong time and wish to sell within a short period, it is conceivable that you could lose money. If you are using the share market just to house your funds and realise a small profit, security is the key.

It is a different story if you are hoping to greatly increase the value of your funds in order to make a purchase. You'll be forced to invest in higher risk companies that may provide the necessary returns but could also fail to perform in the timeframe you desire, reducing the value of your funds.

Attitude to Risk Taking

Some people like taking risks. They jump out of airplanes and parachute to the ground. Or they bungee jump from cliff tops and bridges. Others prefer to keep their feet on the ground. A quiet walk in the bush is more their style. The same applies to buying shares. You have to feel comfortable with your decision. Think about your attitude to risk before choosing stock. If you're not comfortable with the highflying approach, steer clear of shares that offer potentially large returns but with a greater degree of risk. Make sure you'll be able to sleep well at night. Remember that all types of investments are a form of gambling, though some are obviously a higher risk than others.

That's not to say that the share market is the same as a casino or a racecourse (though some shares are in the same league), but no investment can come with a one hundred percent guarantee. When giving your broker details about your circumstances, make sure you include your attitude to risk. It is a factor that can easily be overlooked but which is vitally important. Nervous investors may choose to skirt the risks of the stock market and invest their money in "safe" interest bearing accounts or bonds. But they too wind up facing a risk, though. Their money will not grow fast enough for them to reach their retirement goals.

In the end, risk can't be avoided. No matter what you invest in, there are risks. Even if you store your savings in your sock drawer, it's susceptible to theft or fire or inflation but it is important to understand your attitude to risk taking when you formulate your investment plan.

Taxation Situation

As with anything to do with money, earnings and investing, taxation is also an issue. The way that you purchase shares and the type of return you get will affect the amount of tax that you'll pay. Some dividends you receive may incur a tax; others will come to you tax-free. Selling shares will possibly make you liable for capital gains tax. Again, it depends on your individual circumstances and the types of investment decisions you have made.

It is recommended that you sit down with an accountant or financial adviser before committing yourself to a large investment in the share market. They will be able to go through your income stream and work out the best way for you to invest. Best means less. That is, less tax.

Now, make the time to sit down and make an investment plan. Take into consideration as many of the aforementioned factors as possible. After all, it's your money that we're talking about, and we firmly believe that the stakes are too high and the outcome too important to take this step lightly.

Following is a checklist for you to complete. Once you have ticked all the appropriate boxes, you should have an idea about whether to weigh your share portfolio towards security and dividends or greater risk and higher profits.

Checklist

Age:

☐ **Under 21**	10 points
☐ **21-29**	9 points
☐ **30-39**	7 points
☐ **40-49**	5 points
☐ **50-59**	3 points
☐ **60+**	1 point

Annual income level (other than share investments):

☐ **0 - $5000**	1 point
☐ **$5001 - $15000**	2 points
☐ **$15001 - $25000**	4 points
☐ **$25001 - $40000**	6 points
☐ **$40001 - $70000**	8 points
☐ **$75000+**	10 points

Need for liquid assets:

☐ **Within 1 year**	1 point
☐ **1 - 2 years**	3 points
☐ **2-4 years**	5 points
☐ **4-6 years**	7 points
☐ **6-10 years**	9 points
☐ **10 years+**	10 points

Attitude to risk taking: Which of the following best sums up your attitude to money:

☐ **Reckless**	10 points
☐ **It is there to enjoy**	8 points
☐ **Cautious**	5 points
☐ **I've worked too hard for it to throw it away**	3 points
☐ **a miser**	1 point

Now add up your scores and see how you should balance your portfolio:

- 4-10 You are after security first and foremost. Blue chip stocks all the way.
- 11-16 Security is very important. 80%-20% in favour of secure, low risk stock.
- 17-25 Proceed with some caution. 65%-35% in favour of secure, low risk stock.
- 26-33 Happy to take a few risks but would still like to sleep well at night. 50%-50% between secure, low risk stock and high-risk, growth stock.
- 34-40 Let's go for it. 70%-30% in favour of high-risk, growth stock.

Ten Strategies for Maximising Profit

Now that you've got a basic understanding of shares and the share market, it's time to look at ways to maximise your chances of making good profits by investing in the share market. Some of the following ten points are applicable to everyone. Others should be considered in light of your particular circumstances.

- Understand the nature of the share market
- Understand the investment clock
- Understand the psychology of the market
- Look for value shares
- Buy blue chip growth stocks to hold in the long term
- Buy emerging growth stocks
- Minimise your risk
- Keep an eye on your stock
- Regularly review your portfolio
- Borrowing to buy

Strategy No. 1:
Understand the Nature of the Share Market

Recent company floats, particularly Telstra, led many first-time investors to believe that the share market is an easy way to wealth creation, a virtual cash cow. That is not the case, though profits are certainly there to be made.

Although many first-time investors have seen the value of their investments increase dramatically, it is important for them to understand the true nature of the stock market. The market is a volatile and unstable creature. It has had periods of frantic booms, during which many investors have the opportunity to accumulate great wealth. But these booms have usually been followed by severe downturns, during which time many investors have lost out. Particularly hard hit are those who are highly geared, that is those who have borrowed large amounts of money to purchase their shares.

One successful approach to investing in shares is to be a counter cyclical investor. This means attempting to buy shares during periods when the share market is weak and selling the shares once the market has risen. The main problem with this approach to investing is that it takes courage to buy shares when the mood of the market is glum and when all the papers are talking doom and gloom. It is also brave to sell your shares when everyone else is buying, but it is worth trying, as the results can be fantastic.

Strategy No. 2:
Understand the Investment Clock

Have you noticed how the beginning investor will often wait until the market moves before buying shares or property? The reality is that by the time the beginning investor is aware that the market has moved, the experienced investors have already moved the market to the next level. So, how do they do this? Well, the experienced investors tend to buy before the market starts to inflate and prices start to go up. They do this by understanding the investment clock, which is based on the well-known phenomenon that business cycles occur, on average, every seven to nine years.

Many investors have trouble coming to grips with the probability that events can turn out in such a cyclical fashion. However, history indicates that the probability is very high indeed. The sooner you, as an investor, live through an investment cycle, and see the recurring nature of booms and busts, the sooner you will become a better investor and understand the importance of timing of your investment decisions.

Understanding the investment clock is a useful tool for guiding you along the journey to financial independence. It helps you to know when to invest and the best performing assets at a given point in time. The investment clock is not a really good tool for predicting the timing of economic trends with great accuracy. Its real value lies in its ability to depict the cyclical relationship between the share, property and fixed interest markets and the order in which they occur.

The clock tells you the most appropriate investment medium, considering the prevailing economic indicators such as interest rates, commodity prices and inflation. It shows that the share cycle is followed by the real estate and then the fixed interest cycles. The investment clock has proved accurate in reflecting the market forces that drive the various investment cycles, and the order in which they occur.

Looking at the clock, twelve o'clock is the boom and a rapid increase in the demand for real estate results in property prices increasing. Often property prices rise by 20% per annum during these boom years. As property purchases are primarily funded by borrowing, the increased demand for funds causes the cost of funds, that is interest rates, to rise. As interest rates rise, companies find it harder to make profits, and this together with the fact that the booming property market and fixed interest investments seem more attractive, causes share prices to fall or at least stagnate. As property prices tend to boom at these times and because interest rates rise, the rapid growth of the property market cannot be sustained for more than a few years. Property prices stagnate and even fall.

At about 3 o'clock in the investment clock, the share market is usually doing little and offers few prospects for investors and interest rates are too high to make borrowing for property an attractive option. This is the fixed interest or cash part of the cycle when cashed up investors can take advantage of the high interest rates on offer to lenders by way of bonds, debentures and cash deposits in financial institutions. Other investors just try and battle on paying more interest on their borrowed funds. High interest rates slow the economy and lead us into the recession.

This brings us down to six o'clock; in the depths of a recession and as mentioned Australia has a recession of varying magnitude every seven to nine years. Now investors are either too scared, or cannot afford to borrow money and in time interest rates slowly start falling. Also during these times companies are forced to become leaner and increase productivity. These measures and the slowly improving economy translate into increased company profits and this gradually stimulates share prices to recover.

We are now at about 7 o'clock. At this point in the cycle most people have left the market having sold their shares as a result of the economic downturn and retreated to cash, fixed interest or even property. Interest rates range down to historically low levels and eventually the point is reached where long term investors see value in the market and start to accumulate the better performing stocks. The seeds of the next recovery are sown and eventually equity and commodity prises will rise.

Understanding the cycle and the cyclical relationship between the share, property and fixed interest markets is critical if you want to maximise the return on your investment dollar, with the minimum of risk. You may well ask - why do economic cycles occur in the first place? Why doesn't our market driven economy find a nice equilibrium? The simple answer is that the world economy is a collection of many nations each at their own individual point of the economic clock. And each nation is made up of millions of people each making their own financial decisions as a reaction to, or in the expectation of, other people's decisions. The sheer momentum of all these economies means that they always over swing the mark, resulting in cyclical economic movements.

Strategy No. 3:
Understand the Psychology of the Market

If the economic clock is well understood and the benefits of being a countercyclical investor are evident, why doesn't everyone make a killing? The simple reason is human nature. Two factors drive the share market: greed and fear. As the value of shares in the share market rises, most investors want a piece of the action and will buy more and more shares. This drives the prices up and leads to further buying. Such a market is known as a bull market. Everyone is happy, as long as the prices keep rising.

However, we know that such activity cannot continue indefinitely. The problem is that the emotion of greed is often stronger than rational thought. Conversely, when prices start falling, uncertainty sets in and most shareholders begin selling their shares before the price falls too far. As selling intensifies, share prices continue to fall. Before too long panic sets in as most investors try to divest themselves of their share holdings. This is known as a bear market.

Although investors who keep their stocks should be able to sell them for a higher price once the next cycle comes around, the fear of loss forces many investors to sell their shares. Keeping a level head and understanding the market will give you a distinct advantage. Think how much profit you could make if you stood away from the crowd and were in a position to buy when everyone else is selling, and to sell when the pack wants to buy.

Strategy No. 4:
Look for Value Shares

For newcomers to the market, it may seem hard to identify shares with sustainable valuations. However, taking a little time to understand how companies are valued can pay off. Studying the price to earnings ratio will enable you to judge which shares represent value and which ones are overpriced. The price to earnings ratio indicates the number of times the price covers the

earnings of the share. This ratio is listed in the daily newspapers along side the share's price.

A company with a low price to earnings ratio can be considered a better value stock than a company with a high price to earnings ratio. Over time, companies with low price to earnings ratios have consistently outperformed those with high price to earnings ratios.

One thing to remember is that the price to earnings ratio is calculated on a company's current financial situation. One company may have a higher price to earnings ratio than another but this could be due to an unusual recent situation. Similarly, the other company may have had an unexpected windfall that is unlikely to occur again.

So, before making a decision based solely on price to earnings ratios, it would be advisable to check the price to earnings ratios histories of the relevant companies.

Strategy No. 5: Buy Blue Chip Stocks to Hold in the Long Term

One strategy that has proven its value over time is to be a long-term holder of major growth stocks as these types of companies have proven their ability to deliver superior performance over the medium to long term. Again, this requires regular scrutiny of the market. The most common term for these stocks is 'blue chip'.

Although blue chip companies have a history of regularly returning solid profits and dividends, don't be misled into believing they are immune to economic downturns. They're not. However, they are usually large enough to weather an economic battering better than smaller companies. Companies that fall into the category of blue chip stocks include Telstra, National Australia Bank, Coles Myer and Westfield Holdings.

Whatever portfolio mix you are considering, you should include some blue chip stocks. The proportion you choose will depend on the type of mix you are after.

Strategy No. 6: Buy Emerging Growth Stocks

Buying stocks in emerging companies can be extremely profitable. These companies tend to fall in the category of mid cap (mid-sized) or smaller companies. The rewards from investing in these shares tend to be attractive as many of these companies are in the service and technology sectors of the economy, which at times grow at a higher rate than older manufacturing industries. These companies generally have more room to grow than larger established companies. Medium sized companies are also flexible and can more easily maintain their profitability.

The downside of investing in these companies is that mid cap companies that are still developing their potential are more of a risk than well established, larger and possibly more stable companies. Not all of these emerging companies will fulfill their growth projections. It may also be harder to exit the market when desired as shares in these companies may not be in great demand.

Strategy No. 7: Minimise your Risk

Most shares will rise as the market rises, and will fall as the market falls. There's little you can do to avoid this. However, if you don't have time to watch the market you can take action to minimise the risk of losing too much of the value of your portfolio.

To do this, ensure that the shares that you purchase are representative of companies from a wide range of industries. So that your portfolio does not lose too much of its value when a particular sector is struggling, you should ensure you own shares representing companies from a wide range of industries, including technology, construction, finance, manufacturing, media, resources and retail.

If your shares are all in construction companies, your entire investment value falls when that sector suffers a downturn. However, if you have spread your risk, your investment will be cushioned if other sectors are experiencing growth. The old adage, don't put all your eggs in the one basket, is an apt one for the time poor investor.

Strategy No. 8:
Keep an Eye on your Stock

Keep a constant eye on your stock. Apart from checking the value of your shares, read the newspapers to find out what is happening within your companies. Don't just look at the share price each week. Scan the business pages for news about major personnel changes, or news of strategic decision-making within your companies.

Share prices are very sensitive to factors within the company, as well as to outside economic factors such as interest rate rises and falls, balance of payment figures and the value of the dollar. External factors, such as the international economic situations or wars, can also affect share prices. Therefore, the more you keep informed about what is happening, the better your chances of making correct decisions.

Read the annual reports of all your companies, and if you can, attend the annual general meeting. As a shareholder, you are entitled to attend, to present your point of view and to vote on crucial issues, such as the makeup of the board.

You'll also be given a great deal of information about the current and expected future state of the company, information that you can use to make informed decisions. To be able to do all of this, don't buy stock in too many companies. For most people, keeping up with more than ten companies will prove difficult. If you are able to regularly track your stock, you will also get more enjoyment out of your portfolio.

Strategy No. 9:
Regularly Review your Portfolio

Conditions and situations change, so it is important that you regularly review your portfolio. Every few months, go back to your investment plan and see if your needs or conditions have changed. Consider whether some stock should be sold, or others bought. It may be a good idea to reduce your holdings in a sector that looks set to experience low growth for some time. Or increase your stock in a strong growing sector.

If the share price of one of your companies has been steadily falling and is below what you bought it for, consider whether you may be best cutting your losses and selling out of that company. You may be reluctant to make a loss on that stock but consider it in a different light. Selling now gives you the cash to invest in other stocks which may increase in value. Before long you may have recouped your losses and begun to make a profit. Holding onto non-performing stock is opportunity lost.

Also keep an eye on changes to your taxation arrangements, and changes to the taxation law.

There's no point making handy profits if you've got to hand too much of it over to the government. The key to holding a successful share portfolio is in the portfolio's management. Keep a constant eye on it.

Strategy No. 10: Borrowing to Buy

One strategy that some investors find valuable is that of borrowing to buy shares.
When interest rates are low, investors can expect a far better return from the share market than from banks. The margin between the two investments is often wide enough for you to consider borrowing funds to buy shares. In effect, you're using someone else's money to invest, and using part of your profit to repay the interest.

For example, if you had $25,000 to invest in the share market and if your investment was successful you would get the benefit of the dividends and the capital growth in the share value of $25,000 worth of shares. Alternatively you could buy $100,000 worth of shares by using the same $25,000 as a deposit and using the shares you just bought as collateral or security to borrow the balance of $75,000. Many banks and stockbrokers will lend you the funds to do this. Now you would be able to reap the rewards of the dividends from $100,000 worth of shares as well as the capital gains of a portfolio initially worth $100,000. And you would have still outlaid the same $25,000. This process of leveraging your investment is called gearing and in this case it could multiply your profits four fold.

Many investors have done well out of gearing their share portfolio, and when the market rises they have achieved results much higher than they could have without gearing. But the risk is also magnified. If the share market slumped and on average prices fell by 25%, an investor who started with a portfolio worth $25,000 would now have shares worth $19,500. On the other hand, an investor with a portfolio worth $100,000 has had the value of the shares cut back to $75,000. This means that the value of the initial deposit has been lost and that the bank or broker would ask for their loan to be repaid, as there is no longer sufficient security. After selling the shares, the investor has enough money to pay off the lender but is left without any of the capital. Furthermore, brokers fees and stamp duty would have to be paid.

Negative gearing works best when you have invested in shares that have a high rate of growth over the medium term, and have a relatively low risk of large or prolonged slumps in prices. Also, if you are considering negative gearing, ensure that you have income available from other sources so that if the shares do not perform as expected, or if the dividend income is lower than expected, you are able to cover the difference between your investment income and the interest bill. You also need to have the funds to cover margin calls which occur when the bank or broker asks you to 'top up' your account to provide the security needed because the market value of your shares has fallen.

Because negative gearing allows losses on share investments to be offset against tax payable on other income, the main beneficiaries are high-income earners. Negative gearing is a high-risk investment and there is a risk of losing all your capital - and more! Yet for the right investor, who selects the appropriate stock, the possible benefits may well be worth the risk.

Fundamental Analysis and Technical Analysis

Now it's time to introduce you to two types of analysis used by financial advisers and professional investors to make buy and sell decisions to ensure that share portfolios are performing at their optimum level.

Fundamental analysis and technical analysis are two totally different ways of arriving at how analysts assess a share's real value. Some astute investors use both methods to make their buy and sell decisions.

- An introduction to fundamental analysis
- An introduction to technical analysis

Introduction to Fundamental Analysis

Fundamental analysis involves the use of financial and economic data to evaluate the liquidity, solvency, efficiency and, most importantly, the earnings potential of a given company. The fundamental analyst's kitbag of tools includes the corporate annual report and its financial statements, legal comments by corporate officers, industry statistics and market trends, as well as macro-economic data.

With this information in hand, the fundamental analyst's goal is to ferret out undervalued stocks, and then buy them in anticipation of the appreciation that should occur when this value comes to light.

While it is not critical for the average investor to fully understand how the fundamental analyst goes about his job, it is useful to have a broad understanding of what goes on in his mind when assessing the value of a share. They place a value on individual shares by assessing the following:

Making projections for the economy as a whole using key economic indicators
These indicators include the stock market itself, interest rates, the GDP (Gross Domestic Product), real business investment, corporate profits, prices, the balance of payments and the external value of the dollar.

Stock market
Historically, a marked downturn in the stock market indicates an impending recession some six to nine months away. In these circumstances, it is advisable to sell economically sensitive shares. Conversely, stocks tend to turn upward well before the end of a recession. Thus, a generally good time to buy shares is about six months after the onset of a recession while the overall economy is still mired in the shadow of public gloom.

Interest rates
Falling rates are generally bullish for the economy and the stock market, while rising rates are bearish, tending to restrict growth.

Gross Domestic Product (GDP)
Is a measure of the health of a nations economy. A slowdown in the GDP's rate of growth is negative, while an increase in growth is positive for the economy and the share market.

Real business investment
If companies are spending money to expand markets, develop new products or build new products, they obviously expect the economy to be healthy enough to make a positive return on their investment. When they cut back, it usually means they are expecting a downturn.

Corporate profits
Rising profits generally follow an upturn in the economy, stable profits a transitional period and falling profits a downturn.

Prices
A little inflation is considered good as it acts to spur growth and increase corporate profits. However, too much inflation begins to eat into profits and could signal a downturn.

Balance of payments
When Australia's foreign debts rises, the government and Australian companies have to spend more money to service the overseas debt. However, when foreign debts fall, more resources are freed up to fuel expansion at home.

External value of the dollar
When the Australian dollar is weak, more of our internal assets are required for foreign purchases and debt service, leading to a dampening of our economy. However, when the dollar is strong, the cost of foreign financial activities falls and more money is available for internal investment.

Analysing a company's earnings and dividends
As fundamental analysts examine a company they forecast each company's growth (or lack thereof) for the next year, as well as for some reasonable longer-term horizon - such as the next five years.

Forecasting the market's perception of your company's growth
Once analysts have predicted the future growth of a company, they then project how the market will respond to those figures partly by reviewing the P/E ratio that the market has assigned to stocks in the same industry with the same growth rate over the past few years and extend the trend to encompass the future earnings they expect.

An Introduction to Technical Analysis
While a fundamental approach to valuing a share involves the use of financial and economic data, a technical analyst doesn't look at income statements, balance sheets, companies policies, or anything fundamental about the company. Technical analysis looks at the actual history of trading and price in a security or index. This is usually done in the form of a chart. The security can be a stock, future, index, or a sector.

The technical analyst believes that securities move in trends. And these trends continue until something happens to change the trend. With trends, patterns and levels are detectable. Sometimes the analysis is wrong. However, in the overwhelming majority of instances, it's extremely accurate.

The tools of the technical analyst are indicators and systems which are used on price charts. Moving averages, support and resistance lines, envelopes, Bollinger bands, momentum... are all examples of indicators. These indicators all tell a story.

In the past, technical analysis required powerful institutional computers and teams of mathematicians to interpret the signals. Now with modern software and a home computer, the individual investor has access to the same information as the technical analysts of the large institutions.

15 Common Mistakes Made by Investors

The following list details some common mistakes most investors make. Review them and try to avoid them when making investment decisions.

- Using poor stock selection criteria. Beginning investors don't know what to look for when purchasing a stock and often end up buying shares in lacklustre companies.
- Buying a stock when it's trending down in price. Stocks are usually down in price for a reason.
- Chasing losses. If you buy a stock at $4 and then buy more when it falls to $3, your average cost is $3.50. You are chasing your losses and probably throwing good money after bad.
- Buying low priced stocks. These stocks are usually cheap due to problems. Many institutional investors don't look at low priced shares and institutional sponsorship is one of the ingredients needed to help propel a stock's price higher.
- Wanting to get rich quick without doing the necessary homework. To make money in the stock market, you must spend time doing research, educating yourself, and learning from previous mistakes.
- Buying on tips and rumours. Most rumours are false and even if a tip is correct, the stock still often falls in price.
- Buying companies because they have a familiar name or product. Many of the best investments will be names you may not know very well. However, a little research can lead you towards them.
- Acting on poor advice. Most investors are not able to find good information so it's critical to educate yourself as much as possible.
- Not buying stocks that rise to new highs. 98% of investors are afraid to buy stocks as they begin to move into new high ground. It just seems too high to them. Don't allow your fears to dictate your purchases. Emotions are far less accurate than markets.
- Stubbornly holding onto small losses when you could get out cheaply and move into a better performing stock. Again, don't let your feelings run your portfolio.
- Cashing in small, easy-to-take profits, and holding onto small losses. This tactic is the exact opposite of correct portfolio management strategy.
- Worrying too much about taxes and commissions. Your objective should be to first nail down a worthwhile net profit. After all, if you're not making a profit, you don't have to worry about tax.
- Putting price limits on buy-and-sell orders. Novice investors rarely place orders to buy or sell a share at the market price. This procedure is poor because the investor is quibbling for eighths and quarters of a point rather than getting out of stocks that should be sold to avoid substantial losses or buying into popular stocks.
- Vacillating and not being able to make up your mind as to when to buy, sell, or hold a stock. This is a sign of having no plan and without a plan you're swimming against the tide.
- Most investors cannot look at stocks objectively. They are always hoping and playing favourites, and they rely on their hopes and personal opinions rather than paying attention to the opinion of the marketplace, which is more frequently right.

Conclusion

Let's now sum up the main points raised in this training module.

- Develop an investment plan. Consider as many details pertaining to your financial and personal situations as possible. Taking the time to do so will pay dividends later.
- Consider whether your portfolio should lean towards shares producing strong capital growth or those producing regular dividends. Those depending on their share investments for an income should be looking for regular dividends.
- Be aware that the share market suffers severe slumps, as well as rises. Extraordinary profits cannot be sustained over a long period of time.
- Learn from history. We know that the share market will suffer peaks and troughs. Understanding when the market is likely to rise or fall in the near future can help you maximise your profits on the market. It can also help you to decide where to re-direct your investments when the market is performing poorly.
- The share market is generally driven by greed and fear. A mob mentality rules. If you possess the nerve, and your personal finances allow, go against the crowd. It pays to buy when everyone is selling, and sell when everyone is buying.
- Learn how to identify shares that are good value. Look beyond the share price to a company's true value, the price to earnings ratio. Generally, lower price to earnings ratios are what to look for.
- If you are looking at using the share market as a long-term investment option, learn which companies have consistently returned growth above the market average.
- Try to select a mix of companies, including those in emerging sectors that can be expected to increase in value over the coming years. Most will be in the services sector, Australia's major growth sector. Over time, these stocks may provide greater profits than others, but be aware that they are also a riskier proposition.
- If you are time poor, to minimise your risks it pays to ensure that your portfolio has shares from a wide range of sectors. When one sector experiences a downturn, your finances can be protected by those shares in the better performing sectors.
- Limit the number of companies that you purchase shares in to a manageable number. Make sure that you are able to track what is happening to them, preferably on a daily or weekly basis.
- Every few months, take an objective overall look at your entire portfolio. Perhaps sell poorly performing shares that show little sign of improvement. Or those that have reached a high price that you consider not to be sustainable. Check how each industry sector is performing and what their prospects are for the foreseeable future.
- Think about the benefit of using other people's money to make money for you. When interest rates are low, this becomes a very viable option. However, ensure that you have sufficient alternative funds available if circumstances demand.
- Spend less than you earn. If you're spending more than you earn, you will never be able to become financially independent.
- Save 10% of your net income and invest it wisely. The level of your income has no bearing on the level of wealth you achieve, what is critical is the amount you save.

You should now know something about the share market and about which strategies to consider when purchasing shares. The next step is to discuss your financial situation and strategy preferences with a broker. The broker can then create a portfolio which best suits your individual needs.

With a solid understanding of the share market, you will get a lot more out of your investments. We wish you every success with your investing.

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