

# WHY INVEST IN SHARES?

Investment: the word conjures up grey-shaded images of everything you never wanted to be, such as strait-laced and sensible. But investing doesn't have to be boring – in fact it is the only route available to financial independence

for those of us that aren't 'trust fund kids' or recent lottery winners.

As Graph 1 shows, shares have shown the highest returns in the long term, outstripping other assets such as bank deposits and even property.

## WHAT ARE SHARES?

Companies have two choices when they want to raise money to grow their business: to borrow from a bank or issue shares.

A share is a slice of a company that, technically, means that its owner has a small claim on that business's earnings and assets.

As a shareholder, an individual is one of many

owners of that company. The key advantage of issuing shares (or equity) is that the company doesn't need to pay back the capital amount or make interest payments.

Instead, shareholders – the people who buy those shares – can hope for future capital gains on their investment and may also receive dividends.

## HOW A STOCK EXCHANGE WORKS

The New York Stock Exchange (NYSE), the London Stock Exchange (LSE), Tokyo Stock Exchange and the JSE Limited (JSE) are all, simply, markets for shares.

Stock exchanges offer two benefits:

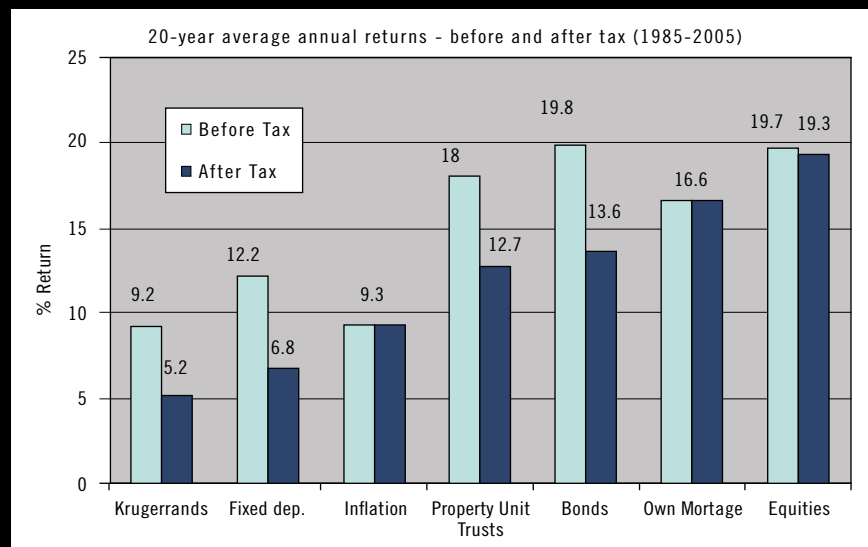
1. They reduce the risk of investing by providing a transparent pricing mechanism for trades.
2. They police listed companies. Stock exchanges operate in a strict regulatory environment and companies have to comply with stringent listing requirements.

## WHAT MAKES SHARE PRICES MOVE?

The forces of supply and demand are the key determinants of changes in share prices. In the simplest terms, the share price will go up if more people want to own a share than are prepared to sell. Over time, a share price will track the underlying trend in the earnings of the company: if earnings (and dividends) grow consistently, the share price should follow. Other aspects that affect investor appetite for shares include the performance of international markets, general economic growth, sector or company-specific news, share buybacks and futures trading.

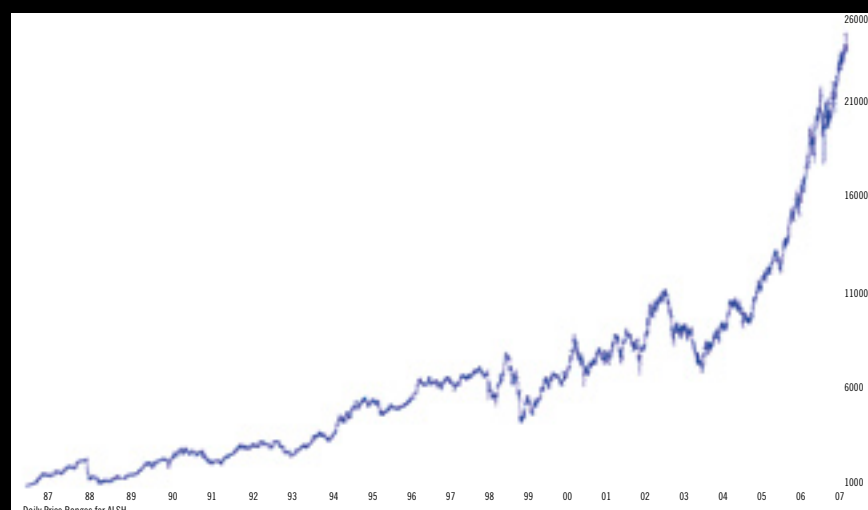
Overall, share prices tend to go up when the economic news is good as this means companies should see their earnings increase. Good news from a certain sector or company can also drive share prices up, as well as creating expectations of good future earnings.

GRAPH 1: THE 20-YEAR RETURN OF VARIOUS ASSET CLASSES



Source: JPMorgan

GRAPH 2: FTSE/JSE ALL SHARE INDEX 20-YEAR PERFORMANCE GRAPH



Apart from individual investors, other buyers of shares include companies (through share buybacks) and futures traders.

**RISKS OF INVESTING IN SHARES**

Share prices can – and do – go down as well as up. Investors can reduce their risk by doing their homework and always knowing exactly what they're investing in. That includes evaluating 'tips from friends'.

Some shares can be illiquid. This means that they are difficult to trade, often because there is a controlling shareholder that owns a large percentage of the company and does not sell those shares in the market. This means a share can be difficult to sell when you want to exit that investment.

Companies do not have to pay dividends. This is not necessarily a bad sign if the company is keeping that money to invest in its future growth, but is a risk for shareholders who

bought that share for the dividend income. If a company goes bankrupt, shareholders may lose the entire value of their investment. Ordinary shareholders only receive what's left over once creditors and preference shareholders have been paid their due.

Companies can disappoint the market by reporting lower-than-expected earnings. This can mean the share price either falls or lags the growth of its peers.

Share prices factor in the market's view of management's competence and integrity. Scandals, such as the revelation of fraud or poor corporate governance, can hurt the share price.

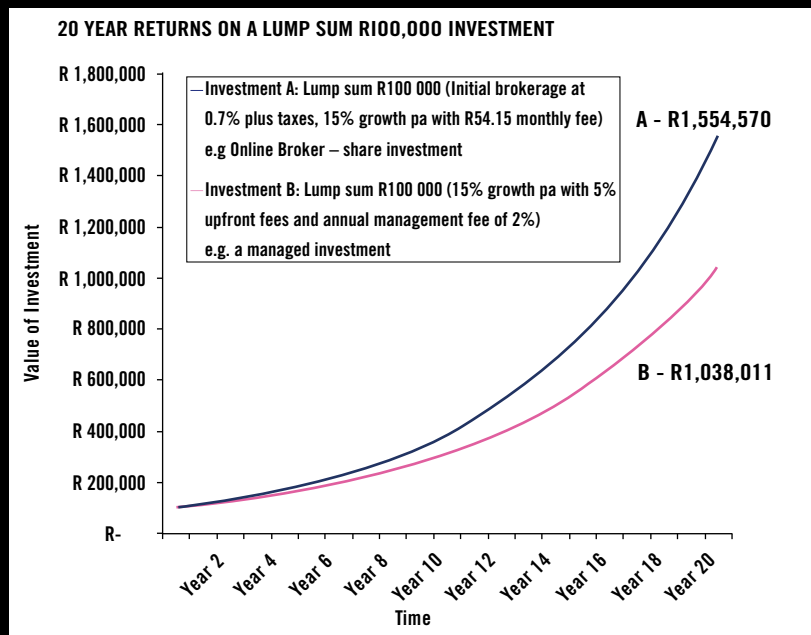
But most listed companies are well-run businesses and their share prices should increase over time, so there is no need for investors to be afraid of investing in companies listed on the JSE.

**THE IMPORTANCE OF CUTTING COSTS**  
Ultimately the value of your investments will be determined not only by the return those shares generate in the future, but also by how little it cost you to invest in the first place.

As Graph 3 shows, you will be better off investing directly in shares rather than letting someone else manage your money.

If you believe that you don't have the skills to manage your own portfolio of individual shares, consider buying an Exchange Traded Fund (ETF). These let you buy an index of shares at relatively low cost.

**GRAPH 3: DIFFERENT INVESTMENT SCENARIOS:  
DIRECT INVESTING VS THIRD-PARTY MANAGED FUNDS**



**INVESTMENT SEMINARS**

The JSE and Online Share Trading from the Standard are hosting a series of free, one-hour educational presentations called 'Getting started in shares'. The presentation covers basics such as understanding the share market, how to make money on the JSE, deciding what shares to buy and how to go about it.

The timetable below shows the seminar dates up to May 2007.

To register, send an email with your name, contact details, desired date and location to [seminars@standardbank.co.za](mailto:seminars@standardbank.co.za).

For more information, visit [www.securities.co.za](http://www.securities.co.za) or call 0860 121 161.

DATES	CITY
6 February, 12 April	Pretoria
8 February, 29 March, 25 April, 3 May	Johannesburg
1 March, 17 May	Cape Town
8 March, 19 April, 10 May	Durban
31 May	Centurion

