Investing: Beginner Series

Everything you need to know about investing

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Understanding why we should invest:

- **Lesson 1:** What are long-term investment goals and why should you have them?
- **Lesson 2:** Why investing your money is so important
- **Lesson 3:** The magic of compounding and what it can do for you as an investor

Different type of investments:

- **Lesson 1:** An introduction to shares
- **Lesson 2:** How to invest in shares
- **Lesson 3:** ETFs
- **Lesson 4:** Unit trusts

Things to consider as an investor:

- **Lesson 1:** Financial market terminology explored
- **Lesson 2:** The typical long-term investor and what they look for

Risks to consider when investing:

- **Lesson 1:** Different types of risk

Investing can be a daunting topic when looked at in isolation. The terminology can be confusing, terms such as: entry price, exit price, margin, call, put and EBITDA can be thrown around by investors creating doubt in new investor’s minds.

We have developed and designed short modules to equip new and advanced investors with investment education to assist them in becoming better investors and in achieving long-term goals. The course runs from a beginner series to an advanced series. The beginner series will focus on introducing beginner investors and traders to key concepts and basics. The advanced series will focus on how to analyse companies to assist in making investment decisions for long-term investments.

The best way to achieve sustainable returns is to educate yourself and understand the different investment vehicles on offer. Working through the educational portal courses will equip you with some of the key basics in the investment world and allow you to make better and more educated investment decisions.

In this beginner series we will cover the following themes:

- Understanding why we should invest
- Different type of investments
- Things to consider as an investor
- Risks to consider when investing

Understanding why we should invest

Lesson 1

What are long-term investment goals and why should you have them?

Topics covered

- What do long-term goals mean?
- What do long-term goals mean?
- What are the types of long-term goals?
- How to become a consistent investor and saver
- Investing and saving for your child's future
- Investing and saving for retirement

The words "long-term investment goals" are not unfamiliar, but what exactly does it mean to invest for the long term and have investment goals?

Long-term goals usually take more than five years to reach. With regard to money, they involve disciplined savings and investment strategies. This can be long-term saving or investing to pay school fees for when your child goes to school or university or long-term investing for that special holiday; however most investors long-term goals essentially come down to saving and investing for retirement. The number one long-term investment goal is to have enough money put aside to retire in comfort.

Regardless of your goal, reaching it means you need to develop good savings and investing habits. Whether your goal is a 5-year or 50-year plan, developing good savings and investing habits is key. Contributing to a monthly retirement annuity, taking advantage of tax-free savings and investing in ETFs or unit trusts are all methods of saving monthly and growing your money long term. Investment returns do not accumulate overnight; consistency and patience result in long-term sustainable returns. Tax-free accounts, retirement annuities, ETFs, unit trusts and many other instruments will be explored during this course.

Becoming a consistent saver and investor can be done in three steps:

1 2 3

Set up automatic monthly contributions to your retirement plans and investment portfolio from your salary. When you don't see money in your bank account, you won't spend it. Instead, you'll save for your goals and your investment account will grow over time. This may be a savings account, fixed deposit, retirement annuity, ETF, unit trust or your own portfolio.

Think about it this way: with as little as R1 000 a month, or R12 000 a year, you can save R480 000 after 40 years. Assuming a 7% annualised rate of return, you would have almost R2 600 000 and that's just on 7% interest. Reinvesting dividends and capital growth could be much higher than this.

A fantastic investment vehicle is a tax-free savings account.

Tax-free savings accounts (TFSAs) were introduced on 1 March 2015 with the idea to create a savings culture in South Africa without having to pay tax on the returns earned. Since its inception over 500 000 TFSAs have been opened and taken advantage of by South African investors.

The current threshold for TFSAs are as follows:

- A maximum of R36 000 per annum
- A lifetime maximum of R500 000

Thus, the immediate opportunity for beginner investors is the ability to invest up to R36 000 per year tax free; this means all interest, dividends and capital appreciation will be the net return you receive as no tax will be paid.

Benefits

Lesson 2

Why investing your money is so important

Topics covered

- What is inflation?
- Why is it important to beat inflation?
- How to beat inflation
- Investing and saving for your child's future
- How to maintain your lifestyle post retirement

Savings should always be compared to the rate inflation is growing. To do this properly one needs to understand what inflation really means.

Inflation means the sustained increase in the general price of goods and services in an economy over time. If your money is growing at a rate lower than the general increase in the cost of goods and services, it essentially means that your savings are losing value year after year. If your money was under your bed for five years, your total lump sum of money would be worth less than it was in the year it was saved. Investing in the financial markets is essentially a risk mitigation technique to ensure your savings do not lose value.

Inflation has a negative effect on consumers as it reduces their purchasing power. That is why it is necessary as a saver and investor to take steps to protect your wealth over your lifetime. One way to protect yourself is to invest in the market, but there are also fixed instruments such as fixed deposits that assist in growing your hard-earned money. One needs to analyse the potential returns from these types of investments versus the current and projected inflation rates.

Inflation has an effect on lots of important aspects in your life. Your salary for one. For most companies the higher inflation becomes, the tougher it is for the business to grow and increase profits – which will result in fewer salary increases. Inflation has an effect on your debt. Higher inflation translates to higher interest rates and thus higher interest payments on your debt. This in turn will affect mortgages, car payments and other sources of borrowings linked to prime interest rates. This means that investments need to be made in order to maintain current lifestyles and beat this increase in costs.

Over the long term, prices tend to go up and the purchasing power of the rand tends to go down. Over time, your purchasing power is going to decline, and you'll need more rands to pay for the same product or service. Today a Coca-Cola (Coke) costs R10.00. If Coke increases at the cost of inflation, it would cost R12.50 in five years time and you would essentially have to pay R2.50 extra for a Coke if your salary or savings do not increase with inflation.

Another crucial aspect for most investors is investing in their children's education. With inflation affecting all industries, the cost of education does not escape the increasing costs year on year. Thus, money set aside today will not be able to purchase the same quality of education in five years' time, unless that money keeps up with the increase in costs.

It is the dream of every parent to give their child a world-class education that could act as a springboard to a highly successful life. World-class education is becoming more and more expensive due to the high demand of top schools in South Africa.

There are a few considerations when planning to invest for your child's education. Some of which are outlined below:

- When will the funds be required?
- How much risk are you willing to take?
- Do you require flexibility to access those funds if they are needed?
- Will your savings beat the inflation and the increase in cost of education?
- Are you going to make monthly contributions or invest a lump sum?

Once you have answered these questions and understand your goals, there are a range of FNB's investment instruments that can help you beat inflation and save and invest in the correct manner for your child's education.

Below is an outline of potential vehicles that make beating inflation achievable. All these vehicles will be fully unpacked later in the course:

Exchange-traded funds (ETFs) | Unit trusts | Tax-free savings account

Money market account | Notice deposits | Fixed deposits

Exchange-traded funds (ETFs) – an ETF is a passively managed investment that tracks a basket of shares or an index. This is a low-cost option to get exposure to a large number of shares that make up an index. Investing in ETFs offers flexibility in terms of how much you contribute, the ability to cash out should you so choose at any time and a low initial contribution from as little as R500. ETFs are ideal when you have a long time before your child starts their education as in general the stock market goes up over the long term. FNB's platforms give you access to a variety of ETFs that track both local and international index funds.

To give a boost to your child's savings and investments you should also take advantage of compounding. Compounding is achieved when all returns from the initial investments are reinvested back into the financial asset, thus increasing the total investment size. The tree is the capital invested and the fruit the returns. The bigger the tree, the more fruit the tree can bear; thus reinvesting all profits will increase the size of your tree, increasing the amount of fruit per year, so your child's education is covered. Compounding will be fully explored in the next lesson.

Using this lesson on instruments will assist in your ability to beat inflation and save effectively for your child's education.

Lesson 3

The magic of compounding and what it can do for you as an investor.

Topics covered

- What is compounding?
- Simple example of compounding
- How to put compounding to work in your investments

Savings should always be compared to the rate inflation is growing. To do this properly one needs to understand what inflation really means.

Compounding is one of those investments terms constantly thrown around in the finance world. The question is, what does it really mean and how does it affect you as an investor? The truth is that compounding is one of the most important concepts when investing and must be fully understood in order to really benefit from long-term investing.

So, what is it?

Simply put, compounding is what happens when you take a number and increase that number repeatedly by a percentage. However, the interest or dividend earned is then added to the initial capital amount and that number then grows by the percentage.

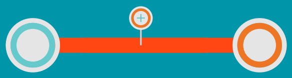
If your capital is R100 and you receive 10% interest or R10.00 in the first year, taking advantage of compounding would mean reinvesting the interest earned so that in year two your money grows at R110 times 10% = R11.00. Essentially 10% interest does not mean R10.00 return each year. It means 10% each year of the initial R100 plus the interest that has accumulated.

Receiving just R10.00 interest a year would mean growing your number by a fixed percentage of 10% as opposed to compounding interest.

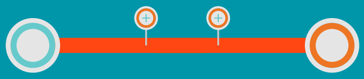
Let’s examine this more closely and fully investigate the difference between fixed interest returns and compounding. You have R1 000 and will receive a 10% return each year on your money.

Fixed return of 10% per year:

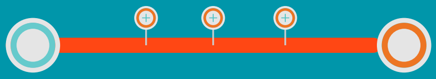
Year 0 (when you start): R1 000



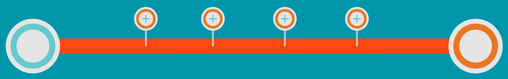
Year 1: 1 000 + 100 = R1 100



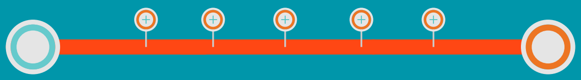
Year 2: 1 000 + 100 + 100 = R1 200



Year 3: 1 000 + 100 + 100 + 100 = R1 300



Year 4: 1 000 + 100 + 100 + 100 + 100 = R1 400



Year 5: 1 000 + 100 + 100 + 100 + 100 + 100 = R1 500+ 100 = R1 400

Now let's examine the full effect of compounding over the five-year period, keeping in mind that you won't just receive 10% based on the original capital amount of R1 000, but now the interest will be added to the capital and then the interest calculated.

Compounding interest at 10% return:

Year 0 (when you start): R1 000

Year 1: 1 000 + (1 000 x 10%) = R1 100

Year 2: 1 100 + (1 100 x 10%) = R1 210

Year 3: 1 210 + (1 210 x 10%) = R1 331

Year 4: 1 331 + (1 331 x 10%) = R1 464

Year 5: 1 464 + (1 464 x 10%) = R1 610

For an investor there are two main streams where compounding comes into play:

Compound returns

Compound interest

Compound returns

Compound returns relate to investing and investment returns. Unlike interest, investment returns can vary and are not usually as stable as a fixed interest returns. However, the concept is the same. Like an interest instrument, an investor receives returns but this time in the form of dividends and capital returns. Because an investor has two streams of potential returns now as opposed to interest returning just one, investing can yield much higher returns over a period especially when compounding comes into effect.

So how do you compound investment returns?

As discussed above, when investing in shares an investor receives two streams of returns: a capital return when the share price goes up and a dividend when the company shares profits with investors. To allow compounding to take effect an investor must do the following with regard to the returns.

Dividends

Capital returns

The bottom line is that compounding makes a massive difference to the long-term investor in achieving long-term sustainable returns. Successful long-term investors let the magic of compounding take place year after year as an effective method of beating the increasing cost of living.

Different types of investments

Lesson 1

An introduction to shares

Topics covered

- What is compounding?
- Simple example of compounding
- How to put compounding to work in your investments

Introduction to shares

Chances are if you have ever invested it has been in a company share. Shares are the most popular financial asset. Physical paper stock certificates have been replaced with electronic recording of stock shares, just as mutual fund shares are recorded electronically. Shares are one of the easiest assets to invest in in the financial markets. Shares are units of ownership interest in a corporation or financial asset that provide for an equal distribution in any profits, if any are declared, in the form of dividends.

There are two types of shares a company may issue: ordinary or preference shares. Most companies issue ordinary shares. As highlighted earlier on in the course long-term investors are looking to invest in shares that will increase in value as well as pay out a dividend. Ordinary shares are generally riskier than preference shares, as company earnings will first be returned to the preference shareholders as opposed to ordinary shareholders. Ordinary shares also come with voting rights, giving shareholders more control over the business. In addition, certain ordinary shares come with pre-emptive rights, ensuring that shareholders may buy new shares and retain their percentage of ownership when the corporation issues new stock. This is known as a rights issue.

In contrast, preference shares do not offer appreciation in value or voting rights in the corporation. However, the preference share has a set payment criterion; a dividend that is paid out regularly, making the stock less risky than ordinary shares. Also, preference shares may often be redeemed at a more beneficial price than ordinary shares. The reason for this is that preference shares take priority over ordinary shares and if the business files for bankruptcy and pays its lenders, preference shareholders receive payment before ordinary shareholders.

Authorised shares comprise the number of shares a company's board of directors may issue. This number of shares is confirmed in the Memorandum of Incorporation of the company. Issued shares comprise the number of shares that are given to shareholders and counted for purposes of ownership. The shareholders' ownership is affected by the number of authorised shares, and therefore the shareholders may limit the number as they see appropriate. When shareholders want to increase the number of authorised shares, they conduct a meeting to discuss the issue and establish an agreement. When shareholders agree to increase the number of authorised shares, a formal request is made to the state through filing a memorandum of agreement.

Share overview

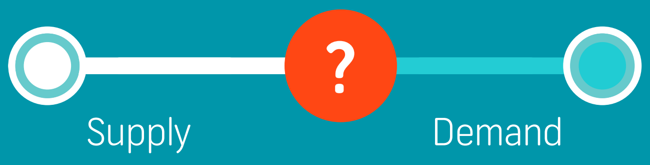
The puzzle as a whole would be the total company value. The red puzzle piece would be one share in the company. If the total company has a value of R100 000 and has 5 000 shares are in issue, a single share would be worth R20.00 (R100 000 / 5 000 shares). As an investor you are buying the share in anticipation that the value of the share will increase. As the share price fluctuates, the value of the company increases or decreases. Thus, the strategy of buying low and selling high comes in to play when investing over the long term.

A company issues shares in order to raise money. One of the main reasons companies list on the stock market is the easy access to capital and raising of funds. For a company to grow, the company needs capital to invest in assets such as stock, equipment or property. By issuing shares to shareholders, the company raises additional capital which creates the opportunity to grow. Thus, companies need shareholders and investors need companies.

Share price movement and the causes

Stock prices change every day as a result of market forces. The share price moves up and down based on supply and demand. If a stock is in high demand, i.e. demand is greater than supply of the stock, that share price will go up. If a stock has more supply than demand, i.e. few investors are buying the stock and there is an oversupply in the market, that share price will come down.

Demand ? Supply



Supply ? Demand

Understanding supply and demand is easy. What is difficult to comprehend is what makes people like one share and dislike another. This comes down to figuring out what news is positive for a company and what news is negative. There are many answers to this question and almost any investor you ask will have their own ideas and strategies.

The principal theory is that the price movement of a stock indicates what investors feel a company is worth. The value of a company is its market capitalisation, which is the stock price multiplied by the number of shares outstanding. For example, a company that trades at R100 per share and has 1 000 000 shares outstanding has a lesser value than a company that trades at R50 but has 5 000 000 shares outstanding (R100 x 1 000 000 = R100 000 000 while R50 x 5 000 000 = R250 000 000).

The most important aspect of share price movement is that share prices are affected by the supply and demand of the share. The higher the demand the more the share price will rise, and the higher the supply the lower the share price will fall. One of the aspects that can affect the supply and demand of shares is company earnings.

Company earnings

Company earnings are the profits that a business makes for a period. When earnings of a company are better than expected, you can expect the share price to go up and when earnings are worse than expectations the share price will go down. A company cannot survive without earnings. Public companies are required to report their earnings four times a year (once a quarter). The JSE regulates the release of these results, as analysts base their future value of a company on their earnings projection. Short-term traders will try and take advantage of the speculation during results season, while long-term investors look to the long-term goal and won't base an investment decision based on earnings speculation. A company's earnings can affect the supply and demand of a share, which will in turn affect the price of the share, making earnings a very important aspect when looking to invest in a company. There are many ratios and indicators that have been developed to assist in analysing a company's earnings, which we will be discussed further into the course.

Market sentiment

Market sentiment refers to the overall attitude of investors toward a particular security or financial market. (A security is an ownership or debt that has value that can be traded; a stock is a type of security.) It is the general feeling or tone of a market, or its crowd psychology, as revealed through the activity and price movement of the securities traded in that market. In broad terms, rising prices indicate bullish market sentiment, while falling prices indicate bearish market sentiment.

Share prices react strongly to market sentiment. Market sentiment can be affected by the earnings of a company, new management, new products being launched or an upcoming merger or acquisition. All these aspects can affect the overall market sentiment towards that specific company. Market sentiment is not limited to long-term investing. Day traders and technical analysts rely on market sentiment, as it influences the technical indicators they use to measure and profit from short-term price movements often caused by investor attitudes toward a security.

Investors typically describe market sentiment as bearish or bullish. When bears are in control, stock prices are going down. When bulls are in control, stock prices are going up. Emotion often drives the stock market, so market sentiment is not always synonymous with fundamental value. That is, market sentiment is about feelings and emotion, whereas fundamental value is about business performance.

Stock price up

Thus, market sentiment is a very important aspect when analysing shares both from a short-term and a long-term perspective.

Lesson 1

How to invest in shares

Topics covered

- The major stock exchanges where you can buy shares
- The role a stockbroker plays when buying shares
- The importance of diversification
- How to invest in shares on the FNB share platform (from funding to share selection) (2 min video)

Introduction

As mentioned throughout the course investing is done with a long-term goal in mind. Before investing in the stock market, as an investor you need to understand a few things first:

1. How much capital to invest
2. Your risk appetite
3. Your investment strategy

Below are a few types of share classes, which can form part of a long-term investor's ultimate investing goal. It is up to you as an investor to decide how to diversify your portfolio with the below in mind:

Income shares | Growth shares | Blue-chip companies

Income shares are a class of stock for investors typically looking for steady income in the form of dividends instead of capital gains. Investors that own income shares receive dividends from the entire fund's performance. An income share carries lower risk than a capital share.

The major stock exchanges

The total value of the 60 major stock exchanges in the world currently amounts to around $69 trillion. However, over 93% of this value is divided between three continents: North America, Asia and Europe. Below are nine stock exchanges that are crucial be aware of when trading or investing:

There are nine stock exchanges that are crucial be aware of when trading or investing:

1. New York Stock Exchange
2. Nasdaq Stock Exchange
3. London Stock Exchange
4. Amsterdam Stock Exchange & Euronext
5. Xetra/Börse Frankfurt Stock Exchange
6. Warsaw Stock Exchange
7. Tokyo Stock Exchange
8. Hong Kong Stock Exchange
9. Johannesburg Stock Exchange

Johannesburg Stock Exchange

The JSE is the oldest existing and largest stock exchange in Africa. It is situated at the corner of Maude Street and Gwen Lane in Sandton, Johannesburg, South Africa. In 2016 the JSE had an estimated 388 listed companies and a market capitalisation of $14.271 billion. The JSE is currently the 19th largest stock exchange in the world.

The role a stockbroker plays

A stockbroker or stockbroking platform's role is to serve as the vehicle through which you either buy or sell stock and other forms of financial assets. In this case FNB stockbroking buys and sells financial assets on your behalf. Although you can buy some stocks directly from the company that issues them, to purchase most stocks you need to go through a broking platform like the one FNB offers.

The distinction between institutional stockbrokers and personal stockbrokers is important:

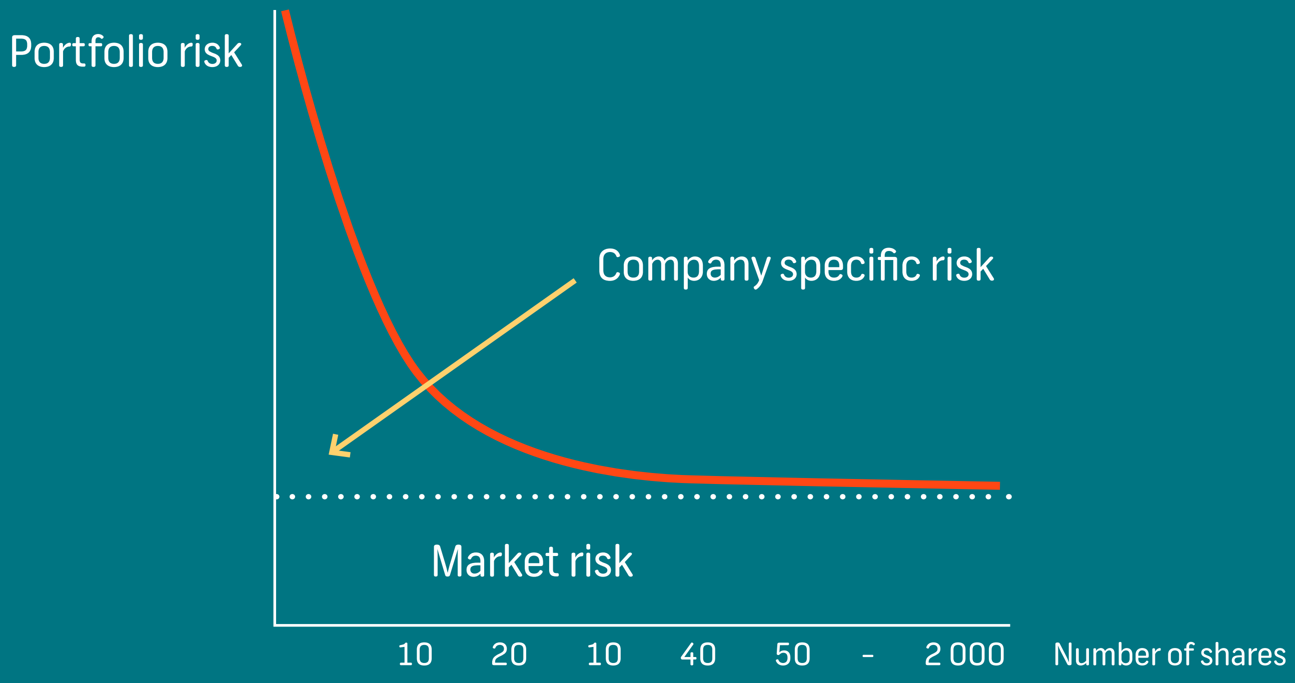
Personal stockbrokers Institutional stockbrokers

Personal stockbrokers like the FNB stockbroking platform offer the same services to individuals and small businesses.

Although the primary task of brokers is the buying and selling of financial assets, brokers perform other tasks including: Providing advisory services as investors pay brokers a fee for investment advice; doing research and writing education pieces such as this that customers also get access to; and offering features such as interest-bearing accounts and electronic deposits. In addition to stocks, brokers can buy bonds, mutual funds, options, exchange-traded funds (ETFs), and other investments on your behalf.

Diversification

Diversification is a risk mitigation technique of spreading money over a number of investments. Instead of investing all your money in one specific stock or sector, you spread your investments over a number of stocks or sectors balancing out the expected risk of investing.



The previous graph looks at portfolio risk, company risk and market risk combined, giving an investor the total risk of investing. Portfolio risk can be reduced through diversification. Portfolio risk is at its highest with 1 share bought, but as the number of shares in the portfolio increases so the portfolio risk decreases. This is diversification in a nutshell. The more shares you are invested in the more the risk is spread over the portfolio, reducing your overall portfolio risk exposure. When deciding on how to diversify your portfolio you have to look at risk appetite first.

What's interesting to note is that diversification can only limit portfolio risk to a certain point. Looking at the graph, once 40 shares have been acquired the portfolio risk doesn't reduce any further with the addition of shares. Thus, diversification can only reduce portfolio risk till a certain point. The key is to diversify depending on your risk appetite but knowing that diversification can never eliminate all risk, only reduce it. The more diversified your portfolio is the less expected return you will generate; the fewer shares you are invested in, the higher the expected return.

Methods to diversify a portfolio include, but are not limited to, investing in a number of different companies, international stock exchanges, sectors, index trackers, international bonds, raw commodities and geographic locations and looking at the correlation of your portfolio.

Lesson 3

Exchange-traded fund (ETFs)

Topics covered

- Defining ETFs
- Practical example of an ETF
- Why invest in ETFs?
- Offshore exposure through ETFs

Exchange-traded fund

Now that you have a firm grasp on shares and investing in shares the course is going to look at ETFs as these serve as the ideal investment vehicle for the beginner investor.

In order to decide if this is the right investment vehicle for you, you must understand what these funds are comprised of first. Let's unpack what an ETF is.

An exchange-traded fund (ETF) is an index-tracking investment tool that is traded in a public market. ETFs are composed of a basket of securities or assets that seeks to mirror the performance of an index. In other words it is an equity fund; however, the basket is listed and traded in the stock market. ETFs typically focus on a segment of the market, such as technology, energy, real estate or on a geographical location such as Japan, USA or Emerging Markets. ETFs follow these indices to track the market's volatility. ETFs are traded on the stock exchange just like a security, meaning you can buy and sell an ETF like you would an equity share.

Let’s break it down further using a simple example:

Imagine the stock exchange was your local supermarket, containing the following food items: Bread, milk, butter, tea and bananas.

BUTTER
BUTTER
BUTTER

In order to purchase each item, you need to pay the full cost of each. If you wanted to buy the full basket you would need R90.00. But say you only had R30.00. Could you say to the cashier “I need all these items but only have R30.00 so could you please pour out some of the milk, take away a few slices of bread and only give me two bananas out the packet”? No, this is not the way a supermarket works, and similarly the stock exchange also does not work like this. In the past without having the full amount of cash required, one could not invest in each one of the sectors required without the full R90.00. However, an ETF does exactly that – the fund will purchase all the items of food at the full cost of R90.00 and repackage the items into three bags containing all the food items at a cost of R30.00 per bag. Now as a buyer you have a full bundle on a smaller scale. And as an investor you will now have exposure to the full set of assets you wish to invest in.

Popular ETFs on the JSE include: Satrix 40, which tracks the Top 40 JSE listed shares based on market cap; CoreShares DivTrax ETF, which is designed to measure the performance of constituents that have followed a policy of increasing or maintaining stable dividends for five consecutive years; and global tracker ETFs such as the Satrix S&P 500 ETF and the Satrix Nasdaq 100 ETF. These global tracker ETFs offer an ideal opportunity for the beginner investor to invest offshore without the daunting task of taking money overseas and selecting international investments yourself.

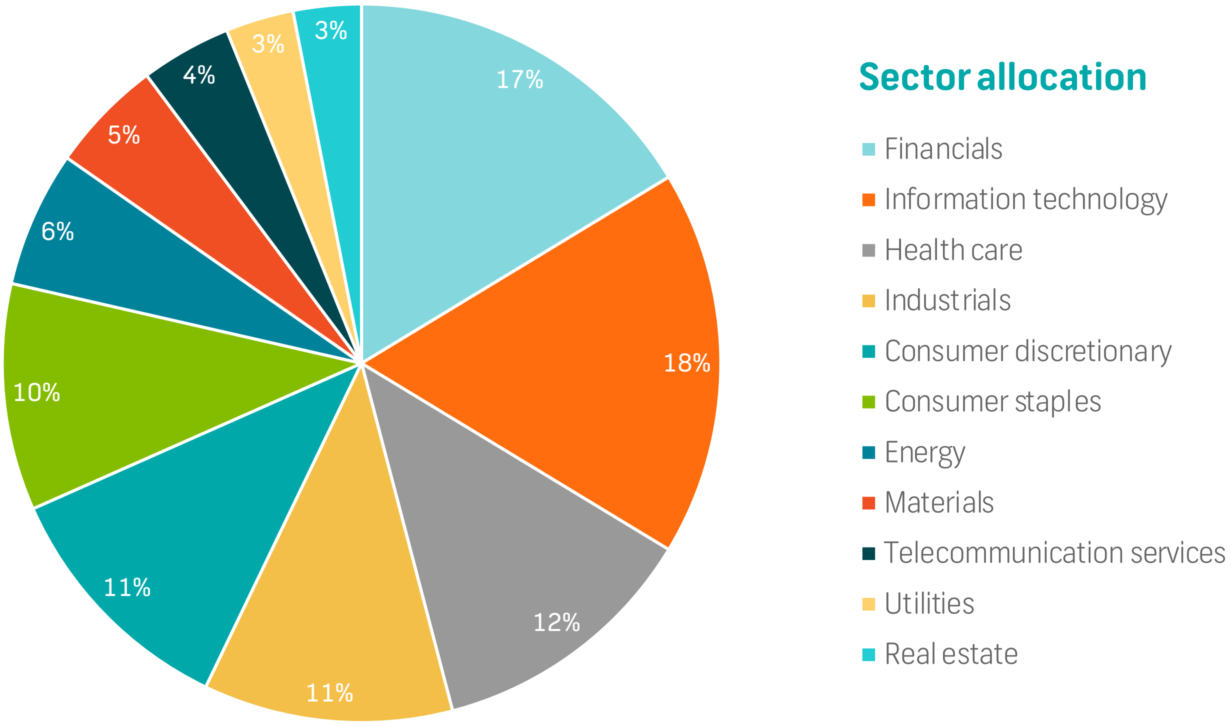
Investing offshore is always a hot topic as it's a must in terms of geographic diversification. International shares have also held up well during the global pandemic. Although there is no guarantee that offshore investing will yield higher returns than the JSE, it is key to diversifying your portfolio.investments.

Diversifying your share portfolio not only relates to different sectors, but geographic locations as well. Should the JSE see a reduction in growth, your investments in international markets might see higher growth and balance your returns out. Hence the concept of “balancing your portfolio”. By limiting your investments to South Africa, all your risk is concentrated in one location. Should anything negative happen in South Africa, your returns will feel the heat of that negativity.

Investing offshore sounds complicated and it can be. Questions such as how to take rands overseas, which countries to invest in and which shares and investments to allocate capital to, can scare investors off from following through. However, one of the easier ways to obtain international exposure is through an investment in a global ETF.

The Ashburton Global 1200 ETF, for example, provides investors with exposure to the global equity market by tracking the S&P Global 1200. The S&P 1200 Index captures 70% of the world market cap, giving investors exposure to 30 different countries. Each stock within the index must meet certain strict criteria – one of which is correct sector representation, resulting in a well-diversified investment vehicle without the daunting nature of taking money offshore yourself and allocating it to the most appropriate investments.

The different sectors within the ETF can be seen below:



South African investors can get exposure to the largest companies in the world with access to this fund, which is traded on the JSE. This results in the perfect vehicle for South African investors to obtain international exposure in the most effective manner by achieving growth and capital appreciation over a long-term period.

The top 10 holdings within the fund include:

Top 10 holdings

Company	Index weight	Company	Index weight
Apple	2.2%	Berkshire Hathaway	0.9%
Microsoft	1.5%	Exxon Mobil	0.9%
Facebook	1.1%	JP Morgan Chase & Co	0.8%
Amazon	1%	Alphabet Inc A	0.8%
Johnson & Johnson	0.9%	Alphabet Inc C	0.7%

Source: S&P Dow Jones August 2017

An experienced investor would be looking to achieve the following when investing offshore:

- Diversification (both geographic and sector)
- Exposure to developed markets
- Investments in some of the largest companies in the world
- Low concentration risk
- Fees and tax reduction

Investing in a global ETF ticks all the above boxes, as well as giving the additional benefit of not eating into your individual allowance of money taken offshore.

There are over 80 ETFs listed on the JSE. You still controlling which ETF you want to invest in, when to buy and when to sell. This means you need to have knowledge and investor confidence in the ETF you are buying or selling.

Lesson 3

Unit trusts

Topics covered

- Defining a unit trust
- What makes up a unit trust?
- Reasons to invest in units trusts
- Difference between a unit trust and an ETF

Unit trusts

A unit trust, like an ETF, is a collective investment scheme where investors’ funds are pooled. However the pooling of the funds is then managed by a professional as opposed an ETF, which you are able to manage yourself. The pooling of funds allows the fund manager to build a large diversified portfolio which then offers investors cost-effective access to the financial markets. The fund manager will allocate the pooled funds to a number of financial assets, giving investors the option of a fully diversified investment instead of investors having to diversify their portfolios themselves. An investor can purchase units of the fund by transferring money into the account. The return from the fund as a whole is then split per unit holder.

How unit trusts are formed

1 2 3

Fund managers* invest money according to fund objective or benchmark

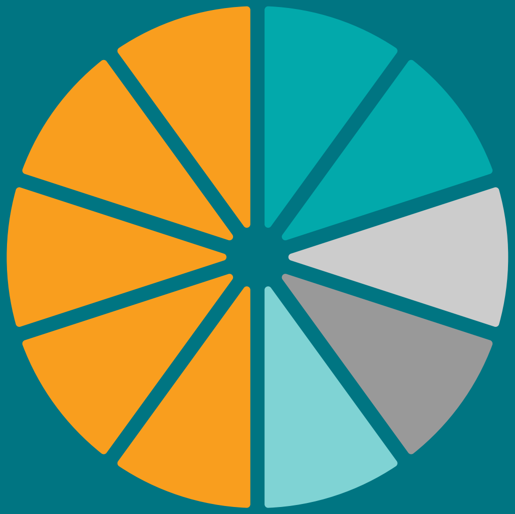
*Earns a fee of up to 2.5% annually from investors.

The assets invested in include the following:

- Money market
- Equity
- Bonds
- Property
- International shares

A fund manager will build different unit trusts that would suit different risk profiles. The higher the risk, the higher the return and vice versa. The share component of the unit trust is normally an investment in an equity ETF that tracks certain sectors or indices such as the Satrix Top 40. However, the fund manager now decides the best ETFs to invest in, when to invest, when to sell and how to reduce costs to enhance return. This is the main difference between an ETF and a unit trust.

To further clarify using another simple example, let' say 10 investors contribute R500 to a unit trust. This unit trust invests in the above assets in the following ratio:



- Money market 50%
- Shares (made up of ETFs) 20%
- Bonds 10%
- Property 10%
- International shares 10%

If we apply the total pooled funds of R5 000 to the different asset classes in the above ratios, we will get the following investment in each asset:

- Money market R2 500
- Shares R1 000
- Bonds R500
- Property R500
- International shares R500

If the total return of the portfolio is R500 for the year, it means that each unit holder will receive R500 / 10 = R50.00 return. The yield is the return divided by your investment, R50/R500, giving you 10% gross yield.

Thus, the difference between the two collective schemes is now clear. A unit trust allows diversification and professional fund management with the purchase of a unit of the trust. An ETF gives you exposure to the sector that has been grouped, meaning you still need to control your investment. With this knowledge in mind, you can now decide on the best investment vehicle to achieve long-term consistent returns.

Things to consider as an investor

Lesson 1

Financial market terminology explored

Topics covered

- Financial assets and the different types
- The financial markets
- The Johannesburg Stock Exchange and its roles
- Market regulation
- How financial asset prices go up and down and how to profit from this

Making money investing

Most investors aim to make money by buying and selling financial assets; buying low and then selling high.

Investors look to buy and hold an asset over a longer period of time, making money when the price of that asset increases.

Conversely, traders look to buy and sell financial assets over a short period of time, trying to take advantage of small price moves on account of market fluctuation.

Financial assets

The financial assets that one would look to invest or trade in consist of the following:

Shares Commodities Forex Indices

Units of ownership in a company, for example Sasol, MTN or Naspers. The more shares you own, the higher your shareholding is in that specific company. This topic has been covered in detain in lessons 1 and 2 of theme 3.

Financial markets

A supermarket is a place that connects buyers and sellers of food, and similarly a financial market is a place that connect buyers and sellers of financial assets. A financial market enables investors and traders to buy and sell financial assets effectively and efficiently as all buyers and sellers are located in the same place. Examples of financial markets include are but not limited to:

- The Johannesburg Stock Exchange (JSE)
- The New York Stock Exchange (NYSE)
- The London Stock Exchange (LSE)

The JSE

The JSE was formed in 1887 during the first South African gold rush. The JSE acquired the South African Futures Exchange (SAFEX) in 2001 and the Bond Exchange of South Africa (BESA) in 2009. Today the JSE offers five financial markets, namely:

1. Equities
2. Bonds
3. Financial derivatives
4. Commodity derivatives
5. Interest rate derivatives

South Africa has mature capital markets that serve the domestic economy and the wider continent. The JSE is one of the world's 20 largest exchanges by market capitalisation $1.005 billion as of August 2020. and the largest exchange in Africa. There are almost 400 companies listed on the exchange across the main board and AltX. The JSE index series is called the FTSE/JSE Africa Index Series and is a partnership between JSE and the FTSE Group. The two benchmark indices are the FTSE/JSE All Share Index, covering 99% of market capitalisation, and the FTSE/JSE Top 40 Index which tracks the top listings in a representative spread of sectors.

2 min video on how one makes money when investing in shares: A long-term investor would be looking at two elements when investing in a certain share.

Capital appreciation

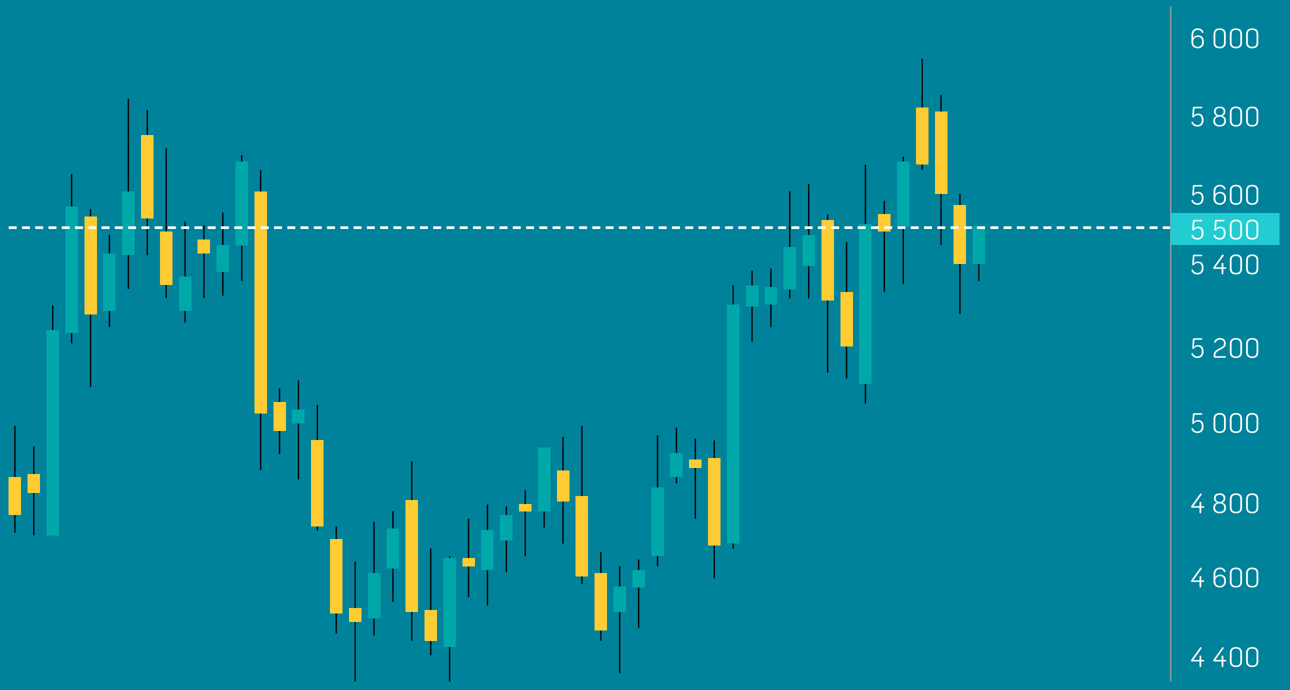
Capital appreciation means the increase in the share price over the period g a specific share is held. Simply put, when buying a share for R100 and the price increases to R110, the R10 would be the capital appreciation of that share. Long-term investors are buying shares with the intention that the share price should move up over a certain period.

Dividend yield

To begin with, one needs to know what a dividend is. A dividend is simply a share in a company's profits. As a shareholder you are entitled to a share of the company's profits when the company declares a divided. The dividend yield is the dividend received divided by the price or cost of the share.

Long-term investors would be looking for a combination of capital appreciation and dividend yield. Typically, the higher the capital appreciation the lower the dividend yield and vice versa, as the company would need to reinvest profits in order to grow and if it is not growing it would have excess profits to distribute to shareholders.

Let's look at Woolworths:



A long-term investor purchases a single Woolworths share on 31 October 2018 for R47.50 in the hope of capital appreciation as well as a 4.5% dividend yield. On past review of data, it shows that Woolworths pays a dividend yield of around 4%. The share is sold on 8 October 2019. How much does that investor receive?

Capital appreciation: The capital appreciation would be R55.10 - R47.50 = 7.60. The long-term investor has made R7.60 on their Woolworths share. Their capital yield is the return divided by the share cost, so R7.60 / R47.50 = 16%.

Dividend yield: Woolworths declared a dividend on 13 March 2019 of R2.22 per share at a yield of 4.28%.

The long-term investor has thus made a gross return of R7.60 + R2.22 = R9.82 before taxes. Always remember there will be capital gains tax as well as dividends tax payable on the above returns, but we will explore these elements in more detail through the course.

Lesson 2

The typical long-term investor and what they look for

Topics covered

- Investing focus on asset growth and long-term outlook
- The typical investor
- Capital growth and dividend yield

When looking at your current savings you should always compare the growth rate compared to inflation and the increase in the cost of living. If your money is growing at a rate lower than the cost of living, it essentially means your savings are losing value year after year. That is why making the correct investment decision is essential to maintaining your current lifestyle when you retire. South Africa's consumer price inflation was 4.5% in June 2019. If your savings was in a shoe box under your bed, you would have essentially been losing 4.5% of value in 2019. This is why it is important to choose an investment vehicle that can beat inflation – to make you savings work for you and allow you to maintain your lifestyle when you start relying on your savings.

Investing in the financial markets is essentially a risk mitigation technique to ensure your savings do not lose value over time. An investor would be looking to invest in assets that increase in value, and thus receive a return that is higher than the cost of living. There is always the risk of those assets going down in value and that is the risk that investors take in order to grow their money.

Long-term investing is all about balancing that risk and selecting assets that meet an individual's risk appetite as well as assets that are likely to move in that investor's favour.

Investment focus

Long-term investing is the strategy of buying low and selling high over a longer period, typically months or years. Long-term investors tend to ignore short-term fluctuations in the market on a day-to-day basis and only tend to monitor the investment on a monthly basis as long-term capital growth is the goal. The strategy can be reworded to buy now and sell higher much later.

Trying to time the market (buying low now and selling high shortly afterwards) can be considered speculating. Buying now and holding for a long time period is investing. Most long-term investors do not want to speculate and rather choose to invest over a long period, to eliminate being penalised for short-term market fluctuations. At the end of the day no one knows exactly what the market is going to do. Long-term analysts will try and predict what an asset will do over a period of time, whereas short-term analysts or traders will try and predict short-term price movements and take advantage of the volatility of the market or asset class at the time of placing the trade. These different techniques will be explored in detail throughout the different courses within the education portal.

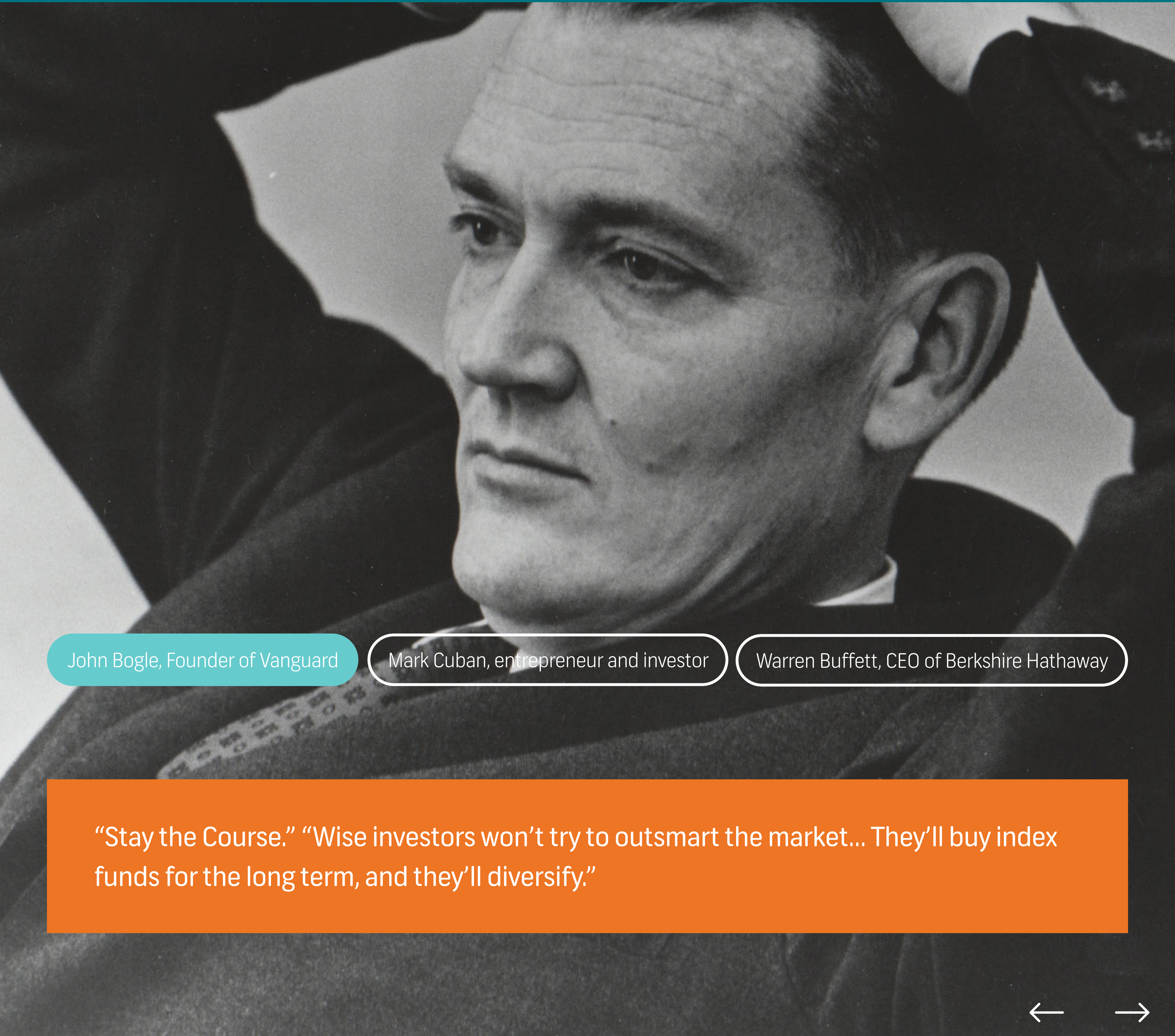
Taking a look at the past 40 years, one thing that stands out is that over the long run, the market tends to go up. $100 invested in the S&P 500 40 years ago would be worth roughly $2 500 today (not adjusted for inflation).

The typical investor

The typical long-term investor is someone who focuses on the long-term value of assets. He or she will build a diversified portfolio that will generate value over a period. The typical long-term investor looks to make a few trades per year, generally looking at holding investments for a minimum of three years.

Let's look at the following simple example:
Matthew is currently 30 years old and has built up a savings account of R100 000. He would also like to contribute monthly to his savings going forward at R10 000 per month. Matthew would like to grow his money by starting a long-term share portfolio. Thus, Matthew would look at purchasing shares initially with the R100 000 and then adding shares monthly as the R10 000 is transferred to his FNB share portfolio. In order to diversify his portfolio, Matthew may look to invest in different sectors, for example a retail share like Mr Price, a mining share like Anglo American, a pharmaceutical share like Aspen and a financial service share like FirstRand. These shares would be invested in for a period typically longer than 12 months, giving the share time to grow as well as Matthew the chance to receive the dividend declared by management. Every month Matthew might add to his current share portfolio and buy additional shares, acquire new shares in new sectors or leave the cash in the portfolio to earn interest. This would be a typical long-term investor.

Lesson 2 The typical long-term investor and what they look for



John Bogle, Founder of Vanguard

Mark Cuban, entrepreneur and investor

Warren Buffett, CEO of Berkshire Hathaway

"Stay the Course." "Wise investors won't try to outsmart the market... They'll buy index funds for the long term, and they'll diversify."

Capital growth and dividend yield

This was briefly covered in lesson 1. We will now build on the information discussed as well as look at the tax implications when making a capital gain and receiving a dividend. Long-term investors will be purchasing assets to own them. What this means is that the physical asset itself – be it the share or commodity – belongs to the long-term investor. Thus, the investor owns the rights to that asset. Should the company declare a dividend to shareholders, holders of the share would receive a total payment of the dividend per share paid multiplied by the number of shares owned.

Long-term investors will hold shares for a long period, thus making the assets invested in capital assets. Therefore, when realising capital appreciation on the sale of that asset, capital gains tax will be payable. Short-term traders are trading to generate taxable income; so traders will generally pay normal income tax on the closing of trades.

What this means for long-term investors is the following:

The current inclusion rate for individuals is 40% and for companies 80%. Individuals also have an annual exclusion of R40 000, which will be deducted from any capital gain on a yearly basis.

Inclusion rate Annual exclusion

A net capital gain for the tax year of assessment is multiplied by the inclusion rate to arrive at the taxable capital gain. The inclusion rate for a natural person is 40%

Looking at a simple example: if Company A buys a long-term share for R100.00 and sells the share for R120.00 three years later, the tax payable on that transaction would be the R20.00 gain multiplied by the inclusion rate of 80% and then the tax rate of 28%. This leaves the company with tax payable of R4.48.

If Company A were an individual the inclusion rate would be 40% and then the tax rate of that individual would have to be calculated using the individual tax tables provided by SARS. For our example let's assume that individual A has an effective tax rate of 30% based on their taxable income threshold. The capital gain would be the R20.00 multiplied by the 40% inclusion multiplied by the 30% tax rate giving them R2.40 tax payable on the sale of the share. Remember that an individual would have a R40 000 annual exclusion that can be applied to the capital gain; the above example assumes this is over and above the R40 000 annual exclusion.

Dividends tax is only payable on the receipt of a dividend by an individual. A dividend paid to a company is exempt from dividends tax.

Dividends tax is calculated at 20% of the dividend received. FNB would receive the individual dividends and withhold the 20% dividends tax. Thus, what is paid into your share account is the dividend post tax.

If that same individual above received a dividend of R5.00 from their share, the dividends tax payable would be the R5.00 multiplied by the 20% rate, which is R1.00. Meaning individual A would see R4.00 arrive into their portfolio as cash. The R1.00 withheld by FNB would be paid over to SARS on their behalf.

Trading vs investing

Investors, as discussed above, focus on long-term asset growth, ignoring short-term fluctuations in the market. However, traders try to take advantage of these short-term fluctuations and make money through short-term price movements. Traders use many technical trading techniques to assist them in reading and trying to predict markets movements.

Who is a typical short-term trader?

When investing long term, an investor can look at the company details, analyse them and enter their position and wait. Post the investment there is normally a level of monitoring, but this is not a full-time job.

When short-term trading, traders need to consider a few things:

? ? ?

Long-term investing has a much lower risk profile than short-term trading; however, the potential returns are much greater in short-term trading as the volume of trades, as well as the leveraged position, are higher. The typical short-term trader is someone who has spare money to trade with (an amount that will not break the bank should the market move against them), has time to analyse and monitor trades daily, and has a developed trading strategy that they believe will assist in yielding positive returns.

Risks to consider when investing

Lesson 1

Risks to consider when investing

Topics covered

- Different types of risk

Investing your money in the stock market always comes with a degree of risk. Risk trade-off theory states that the higher the potential return, the higher the risk. When growing your money through a cash-secured savings vehicle like a fixed deposit, risk is low, as your capital is guaranteed. The major difference when investing in stocks is that capital is not guaranteed, and risk needs to be managed through diversification. The below outlines all the risks associated when investing in the stock market.

Market risk

Refers to the risk of your investment declining in value because of certain economic developments or other events that affect the entire market. Market risk can be broken down into three categories as follows:

1 2 3

Liquidity risk

Liquidity risk is when you are unable to sell your investment due to low demand for that specific asset. There are certain less popular investments that can be harder to sell. To sell the investment, you may need to accept a lower price. In some cases, such as exempt market investments, it may not be possible to sell the investment at all.

Concentration risk

Refers to the risk of loss because your money is concentrated in one investment or type of investment. Concentration risk can be high when invested in a single stock or if a portfolio is overexposed to a sector or industry. This type of risk is an example of putting all your eggs in one basket. This risk is managed through diversification and ensuring concentration and portfolio risk are spread through the inclusion of multiple assets in a portfolio.

Credit risk

Credit risk relates to the issuer of your investment not honouring their obligations. That is, simply not receiving what you were promised when investing. A government bond pays regular coupon payments. Should the government default on these coupon payments, you will not receive your return. The same can be said about companies and preference shares. Credit risk can be evaluated by looking at the credit rating. A credit rating of AAA indicates the lowest credit risk.

Inflation risk

The risk of a loss in your purchasing power because the value of your investment does not keep up with inflation. Keeping up with the cost of living is essential when looking to maintain and grow wealth. Putting all your money in low-risk cash instruments could result in your returns being lower than the increase in the cost of living, meaning your money is losing value each year. Investing in stocks is one way to try and overcome this through higher potential returns.

Horizon risk

The risk that your investment horizon may be shortened because of an unforeseen event, for example, the loss of your job. This may force you to sell investments that you were expecting to hold for the long term. This can result in selling those investments at an unfavourable time or not giving those assets the time needed to perform. That is why it is essential to have emergency savings of three months' expenses put away.

Although investing comes with a degree of risk, this risk can be managed through diversification and fundamental analysis of the investments chosen. Ultimately, this can be done through the inclusion of multiple assets in a portfolio, so overall risk can be spread and ultimately reduced. Risk needs to be in line with long-term goals. The higher the potential risk of an investment, the higher the potential return needs to be. Successful investing is about managing risk correctly and ensuring investments are made in a balanced manner.

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