



# SMARTER INVESTING

**Build wealth and secure your future**

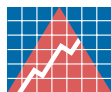


AUSTRALIAN BANKERS' ASSOCIATION INC.





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**AFMA**



**ASX**  
AUSTRALIAN SECURITIES EXCHANGE

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#### **Important Note**

This booklet gives information of a general nature and is not intended to be relied on by readers as advice in any particular matter. We suggest you consult your financial adviser on how this information may apply to your own circumstances.

#### **Acknowledgements**

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## UNDERSTANDING INVESTING





# INTRODUCTION

## UNDERSTANDING INVESTING

The importance of saving is drummed into us all from an early age. To make the most of your money, however, you need to take the next step – to invest those savings the best way you can.

In fact, although you may not know it, you are probably an investor already. Anyone who owns a house, has money in superannuation, or has opened a term deposit, is an investor.

Investing is about making your money work harder for you and helping you to achieve your financial and life goals. It is not just for people who are already wealthy or for those who are soon to retire. Regardless of your stage in life, knowing more about the basics of investing can help you to secure a better financial future.

An investment can be a simple term deposit with your bank or a diversified investment portfolio that includes cash, shares, property and fixed interest assets both in Australia and overseas. As a matter of fact, such a portfolio is not as hard to achieve as you might think.

This booklet is designed to show how investing can benefit you. It explains how to set realistic investment goals that fit your individual circumstances, and how to plan an investment approach that gives you the best chance of achieving those goals. The main investment options that are open to you will be discussed, and the important link between risk and return explained. Some potential pitfalls and how to avoid them are considered. Finally, there is some guidance on how to go about finding financial advice you can trust.

# INVESTMENT BASICS

Saving and investing is the means by which you can achieve your financial and life goals.

Perhaps you have a specific goal such as buying a home, enrolling in further education, preparing for having a family, or taking an overseas holiday. You may have no specific purchase in mind, but simply financial security as your goal. Financial security gives you the confidence that you have a sufficient reserve of funds to call on should unexpected circumstances arise.

Whatever your aim, investing wisely can help you achieve it.

## WHAT IS AN INVESTMENT?

Investment can be defined as the use of money to generate income and/or capital growth. It involves outlaying money now to purchase something that in future will produce a return.

The expectation of a future return is what separates an investment from other purchases. For example, the purchase of a car would not usually be classed as an investment. Over time, the value of the car will fall, and it will end up being worth less than what you paid for it. It also produces no income.

On the other hand, money placed in a term deposit in the bank is an investment because it produces income in the form of interest payments. Share purchases are investments, as they are made with the view that the value of the shares will increase. They may also produce income in the form of dividends.

What all investments have in common is that they involve committing money today with the aim of producing a return in the future. To invest effectively, then, an investment plan is essential. If you take the time to make a plan and have the discipline to follow it, the rewards are well worth the effort.

## DIVERSIFICATION

'Diversification' is an investment technique that mixes different kinds of investments in a portfolio.

An 'investment portfolio' is a group of assets, such as cash, shares, bonds or property, held by an investor. To reduce their investment risk, investors tend to hold more than a single asset. A diversified portfolio, on average, poses lower risk than a single investment within a portfolio.

For more information on diversification, see page 24 of this booklet.

## RISK AND RETURN

There is a fundamental link between an investment's return and its risk.

Some investments, such as deposits in bank accounts, offer relatively low returns, but are regarded as very low risk. Others, such as shares in speculative mining exploration companies, offer the possibility of high returns, but also the possibility of significant losses.

For more information about understanding risk and return, see page 20 of this booklet.

### Did you know?

It is always important to consider the risk and return characteristics of an investment in deciding whether that investment is appropriate for you. An investment that is suitable for one investor may not necessarily be right for another.

## COMPOUNDING

A popular phrase used in the financial press is the 'magic of compound interest'.

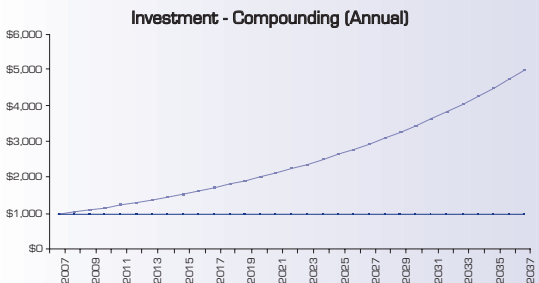
'Compounding' is the process by which an investment will increase in value by ever-greater amounts each year, if interest paid on the investment is reinvested. While the interest rate itself may not change, the amount of interest grows as it is being earned on a larger sum.

### Did you know?

Many financial institutions have a compound interest calculator on their website. ASIC's FIDO website also has a compound interest calculator which shows what your money could be worth or how much money you may have to invest to reach a target amount. See [www.fido.asic.gov.au](http://www.fido.asic.gov.au).

## EXAMPLE

If you invest \$1,000 in an account paying 5.5% interest, at the end of the first year you have earned \$55, and your \$1,000 has become \$1,055. The following year you will earn interest on \$1,055, not \$1,000, so will receive \$58 interest (5.5% of \$1,055). At the end of 30 years your initial investment, with interest reinvested, would grow to almost \$4,985\*.



\* This figure assumes interest of 5.5% before tax, any fees or charges, and inflation.



## MAKING AN INVESTMENT PLAN

There are a couple of steps in making an investment plan. The first is to assess your current financial circumstances. The second is to decide your investment goals and personal objectives.

Once you have done this, you can consider what investments will best help you to achieve those goals.

### **STEP 1: ASSESSING YOUR CURRENT CIRCUMSTANCES**

#### **HOW MUCH MONEY DO YOU HAVE TO INVEST?**

Many people think that a substantial amount of money is needed before investments can be made. This is not the case. An investment plan can be started with a relatively small amount of money.

You need to decide how much you have to start your investment plan, and how much you can contribute on a regular basis. Think about how much money you make, and how much you are able to put aside to invest each month.

One approach is to make an initial investment, and put in place a program where a set amount of money is invested on a regular basis. For example, some managed funds allow you to make small contributions every month. Having such a plan encourages a disciplined approach to investing.

### **TIP**

A smart investor usually starts off by being a smart saver. For more information on building good money habits, developing a budget and putting in place savings strategies, read 'Smarter Money: Take control and stay on top of your finances' booklet available as part of this range of publications. Freecall 1800 009 180 for a free copy.



## DO YOU NEED ACCESS TO YOUR MONEY?

How much money do you need to have available at short notice? Financial and personal circumstances can change unexpectedly, and it is wise to keep a reserve of funds available for use at such times.

This amount should be kept in the form of 'liquid assets'. Liquidity refers to the ability to convert an asset into cash quickly and without any price discount.

There are two aspects to be considered.

- **Ease of converting the asset into cash.** An investment in a savings account or cash management trust is considered a liquid asset, as money can be withdrawn very quickly. Most listed shares are also considered liquid, as they are traded on a daily basis on the stock market, and there is a ready pool of buyers and sellers. On the other hand, an investment property is not considered a liquid asset. It takes time to organise a sale, and then more time for funds to be received. There is also no guarantee that a buyer will be found within the desired time. Finally, if you just need a few thousand dollars, it is not possible to just sell part of a house.
- **Price at which you might be selling the asset.** With a savings account or cash management trust, you have the security of knowing how much you will be able to access and the value of the asset. On the other hand, the future price of shares you hold can't be predicted with any certainty. So while shares are easily converted into cash, the short term fluctuations of the stock market may mean you don't receive as much as you had hoped.

While it is usually unnecessary for all your investments to be highly liquid, you should think about how much money you would like to have easy access to and make sure that a portion of your funds is held in liquid assets.

## HOW MUCH RISK CAN YOU TOLERATE?

The risk and return characteristics of investments are fundamental, and are covered in more detail on page 20 of this booklet.

Just as important as the risk and return characteristics of an investment, is your own level of tolerance to risk, known as your 'risk profile'. The level of risk that is right for you depends on your personal and financial circumstances, your investment goals, and your attitude towards risk.

What are your personal and financial circumstances? Ask yourself the following questions:

- How secure is my job, and the jobs of others in my household?
- What would happen if I lost my job – how soon could I regain an income?
- How many people depend on me to bring an income into the household?
- How much money do I need to live on now, and how much will I need in the future?
- Do I depend on my investments for income?

Your personality is also important. Some people are comfortable with taking risks, and accept the possibility of loss that goes with investments that also offer high returns. Other people are by nature more conservative, and are happy to accept lower returns for the security of lower risk.

There is no 'right' approach – only an approach that is right for you. Ask yourself the following questions:

- How would I describe my investment style – conservative or aggressive?
- Will I lie awake at night worrying about losing money?
- Am I prepared to accept the possibility of losing money on an investment?
- If the value of an investment fell by 10%, how would I feel? By 20%? By 30%?

Your approach to risk must also be considered when setting your investment goals. For example, if your aim is to turn \$100,000 into \$2 million over five years in order to buy your dream holiday house, you will not achieve this by investing in low risk investments such as term deposits.

## TIP

There needs to be a match between the goals you set, and the risk you are prepared to accept to achieve those goals. You may need to modify your goals if you want to stick to investments that are appropriate to your financial and personal circumstances and tolerance to risk.

## TIP

As your personal and financial circumstances change, you may need to alter the mix of your investments, and adjust the balance of income versus capital growth producing investments.

### STEP 2: SETTING YOUR INVESTMENT GOALS

Once you have assessed your current financial circumstances, it is time to think about your investment goals and personal objectives. Where do you want to be in two, five or ten years? Having clear financial and life goals will make it easier to construct a plan to get you there.

Examples of goals include:

- Pay off the mortgage in ten years
- Buy a car in two years
- Save for a child's education in five years
- Take an overseas holiday in three years
- Accumulate a certain amount of superannuation by retirement age

Everyone's investment goals will be different. But, whatever your goals, being specific about them will help you to devise the most effective investment plan. For example, setting a time frame (pay off the mortgage in ten years) or a specific amount of money (\$10,000 for an overseas holiday) can be more helpful than a broad goal such as to 'save more money'. If you are investing for retirement, think about what age you would like to retire (retire at age 65), and how much money you think you will need to live on once you are retired (retire with \$40,000 a year to spend).

Having clear goals will help you to devise a more focused investment plan. It also helps you to measure how well you are going along the way. If you have a time frame and an amount you're trying to achieve, you can set intermediate goals along the way to assess your progress. Depending on how you're going, you may decide to adjust your investment plan or reset your investment goals.

A sense of progress is also important in encouraging you to maintain a disciplined approach. Passing measuring posts along the way shows you that you're on the right track to your ultimate goal.

### INVESTMENT RETURNS

Some investments offer returns in the form of 'income'. Other investments give returns in the form of 'capital growth'. Others offer a combination of income and capital growth.

You may want an investment that gives a regular income, such as a term deposit that pays interest. Or, if you have a steady job that pays you a regular income, you may not need income from your investments and might prefer an investment that gives you capital growth over time.

If you are retired you may need both income and capital growth. In this circumstance, you may want a mix of investments that provide financial security, give a suitable income and increase in value so that you can continue to receive a return throughout your retirement.

For example, many shares pay dividends twice a year and also offer the possibility of capital growth as the share price rises. An investment property generates income in the form of rent and capital growth as the value of the property increases.

### INVESTMENT TIME FRAME

Your investment time frame (also known as your investment time horizon) will depend primarily on what your investment goals are, and what stage of life you are at.

If your goal is to make enough to afford an overseas holiday, you may want to achieve this within two or three years. If you are investing for your retirement, your time frame is likely to be much longer.

The time frame is an important factor in deciding what investments are suitable for you. Some investments have a relatively long investment cycle. For example, residential property is usually regarded as having a 7-10 year investment cycle. This means that while there may be downturns along the way, historically those who have held property over the full length of a property cycle have made money.

Someone looking to invest for only a couple of years, however, might find the time they want to sell coincides with a downturn in the investment cycle. With a relatively short time frame, another investment may be more appropriate.

Your stage of life is also important. If you are approaching retirement, you may prefer a conservative approach, with the main aim being to preserve capital. As a younger investor you may consider a more aggressive approach. Short term fluctuations in the value of your investments will not be so damaging if you are planning to hold your investment for a longer period of time.

## TAX

Returns from your investments are generally taxable. Income from your investments must be included as part of your assessable income for taxation purposes. If you sell an investment at a profit, the capital gain you have made will be taxed, known as 'capital gains tax' (CGT).

The taxation benefits of some investments are significant. For example, if a share pays a fully franked dividend, this means that the company has already paid company tax on the amount of the dividend. You will receive a tax credit for the tax paid by the company, which can be used to offset the tax payable on your other income.

Superannuation is another type of investment that has taxation benefits. Some of these are discussed in more detail on page 18 of this booklet.

One of the most important things to remember, however, is that you should make an investment for the returns the investment itself offers, not solely for its taxation benefits. A poor investment will not become a good one simply because it offers tax relief.

Taxation is a complex area, and the taxation implications of an investment may vary from person to person. You should speak to your accountant or tax agent about your individual circumstances to ensure that your investments are as tax effective as possible.

## Did you know?

Capital losses can be offset against capital gains so that it produces the smallest net capital gain subject to the following rules:

- current year capital losses must be offset against current year capital gains before net capital losses from earlier income years
- net capital losses from earlier income years must be offset in the order in which they were made
- capital losses from collectables can only be offset against gains from collectables, and
- capital losses from personal use assets are disregarded.

For more information about the capital gains tax (CGT) discount, see [www.ato.gov.au](http://www.ato.gov.au).

## TIP

As your personal and financial circumstances change, you may need to reassess your investments, and change the time horizon of your investments to match your changing goals.

## INVESTMENT PLAN CHECKLIST:

Before considering what investments are right for you, ask yourself:

- What are your financial and life goals? What are your personal objectives and needs?
- How much money do you have to invest? Have you completed a budget?
- What assets and liabilities (expenses) do you have?
- Do you want to make regular contributions?
- What level of risk can you tolerate? Do you know your 'risk profile'?
- What return do you want – income or capital growth or both?
- What is your investment time frame – do you need access to your investments?
- What are your tax circumstances?

# FINDING THE RIGHT INVESTMENTS

Having assessed your current circumstances and specified your investment goals, the next step is to decide what investments will give you the best chance of achieving those goals.

There are literally thousands of different investments available. It can be overwhelming to be faced with so many options to choose from. The key to being a successful investor is never to lose sight of the reason you are investing, and to look for investments that meet your investment criteria.

In this section of the booklet, we will consider the characteristics of each asset class, and what it offers you. We will also explain how you can go about investing in each class.

## ASSET CLASSES

An 'asset class' is a group or type of investment. The four basic asset classes are:

- 1 **Cash** – short term investments where your money is held in an interest-bearing account.
- 2 **Shares (also known as equity securities)** – you share ownership, usually in a listed company.
- 3 **Fixed interest (also known as debt securities)** – your money is loaned out to someone else and you earn a fixed or floating rate of interest.
- 4 **Property** – investment in residential, commercial or industrial property, or land development.



## MARKETS

A market is where you can buy or sell your investments. A market brings together buyers and sellers of financial products. Another way of describing it is that financial markets enable the flow of capital from those who have money to invest to those who need money. The buyers of financial products are the investors, in other words you!

Another important participant in financial markets is the 'intermediary'. You can think of the intermediary as a middleman. As an investor, very often you will not deal directly with the supplier of the product you are investing in, but with an intermediary who brings buyers and sellers together. For example, when you buy shares on the stock market, you don't deal directly with the person who sells the shares to you – the trade is handled for you by a stock broker.

Similarly, banks act as intermediaries when they take deposits from those who have money to save, and then lend the money from the deposits to those who need to borrow money. Without intermediaries borrowers would have difficulty finding lenders.

Intermediaries include banks, financial institutions, such as superannuation funds and insurance companies, and brokers.

Now let's take a look at some different types of investments.

## COMMON TYPES OF INVESTMENTS

### CASH

Cash is the simplest investment of all. When we talk about cash in this context, we are of course not referring to actual bank notes. Cash investments refer to money held in liquid form, able to be accessed at very short notice. For example, cash can include bank savings accounts, term deposits and cash management trusts (CMTs).

You are probably familiar with the everyday savings account. The returns are generally lower than from other investments, but the risk involved is low, due to the stringent criteria applied to banks by the Australian Prudential Regulation Authority (APRA).

While not strictly speaking cash, short term deposits can be considered in this asset class. A term deposit will give you a higher return than a savings account, for a fixed period of time. The rate of interest varies according to the term. Generally, the longer you invest your money for, the higher the rate of interest you will earn. You need to remember, however, that your money is locked away for the duration of the term. If you need to access your money early, there may be a 'break fee'.

CMTs are a popular short term interest-bearing investment. They offer indirect access to the money market by pooling the funds of individual investors and investing them in money market securities. They are generally regarded as low risk because of the type of instruments the CMT invests in – highly rated issues from issuers such as banks and state governments.

## TIP

Banks and other financial institutions usually have their current term deposit interest rates advertised. Rates can fluctuate daily, so keep an eye out for times when the rates appear to be rising, because you may be able to take advantage of a good rate for a relatively short term investment.

## MONEY MARKET

The money market is the professional market for short term debt instruments maturing in one year or less. These securities include treasury notes, bank bills and promissory notes.

The overnight rate or 'cash rate' is the price paid for funds placed on the market overnight.

The 90-day bank bill rate indicates the expected rate over the following 90 days.

The money market is a wholesale market. Its major participants include the Reserve Bank of Australia, banks, superannuation funds, insurance companies, investment trusts and large corporates.

### Did you know?

As an individual investor you are unlikely to invest directly in the money market, however; by depositing your funds in a savings account, or placing your money in a CMT, you are indirectly accessing this market. The bank or fund manager takes your money, pools it together with the funds of other investors, and invests it in money market securities.

## SHARES (ALSO KNOWN AS EQUITY SECURITIES)

A security can be thought of as an instrument that has financial value, and that can be transferred from one party to another.

An 'equity security' or 'share' signifies that you own something. For example, when you buy a share in a company, you become a part owner of the company. If the company does well, hopefully its share price will rise, and your investment will increase in value.

The company will be seen as attractive by investors, who will therefore be prepared to pay more to own a part of it.

Share owners often also get the benefit of an income from holding shares, known as a 'dividend'. Dividends are usually paid twice a year and are paid out of the company's earnings.

Dividends are income and so are subject to income tax. Investors get a credit for the tax already paid by the company on its earnings, which can be used to offset other tax payable by the investor.

But not all shares pay dividends.

The payment of a dividend is at the discretion of the company's directors. If the company is performing poorly, the amount of the dividend may be reduced, or the payment of dividends may be suspended.

As a share owner, you have both the benefits and the risks of ownership. If the business does well, you will benefit from an increase in the value of your investment, and possibly some income along the way. If the company performs poorly, your investment may well decrease in value. In the very worst case, the company may go out of business, leaving you with a worthless investment.

## EQUITY MARKET

The main equity market (also known as a 'stock market') in Australia is the Australian Securities Exchange (ASX). There are many stock markets around the world.

If a company has its shares listed on ASX, it is referred to as a listed, or public, company.

When a company first lists on ASX, it issues new shares to investors. The company then uses the capital it raises from investors to fund its ongoing operations, or for expansion or acquisition purposes. From time to time, companies that are already listed may issue new shares to raise further capital.

If you buy shares in these circumstances, you are buying on what is known as the 'primary market'. In other words you are subscribing for shares directly from the issuer of the shares, the company itself (though the sale process is usually handled by an intermediary such as a stock broker).

A company float, or initial public offering (IPO), is an example of a primary market issue. A company that is raising funds will generally publish an offer document, the most common of these being a prospectus. You should read the prospectus to help you to make an informed investment decision.

Once the company's shares are listed, trading of the shares takes place in the 'secondary market'. This is generally what is meant by the 'stock market'. Every day, millions of shares are traded on ASX. In this case, an investor is buying the shares from another investor and the proceeds of the trade go not to the company, but to the investor selling the shares.

When you buy or sell shares, you receive a contract note containing the details of your trade, including the number of shares you traded, the share price, and the brokerage charged. You also receive a statement called a CHESS statement. A CHESS statement is like a bank statement for your shares, indicating the number of shares you hold and any recent transactions you have made.

As an investor, you can't directly buy or sell shares on ASX. You must trade through an ASX Participant, more commonly known as a 'stock broker'. Brokers charge you a fee for their services, usually in the form of a commission (brokerage) on trades they execute for you. The commission rate varies according to whether the broker gives you advice, or simply executes the transaction for you.

You may give your stock broker instructions over the phone, or alternatively place orders over the Internet without ever speaking to an adviser.

For more information on the stock market and tips on selecting a stock broker, go to [www.asx.com.au](http://www.asx.com.au).

## TIP

There is a level of risk and reward to an investment in any company. With so many to choose from, it is important to match your choice to your own circumstances and the investment goals you have set for yourself. If you are new to the stock market, it is probably worth finding a financial adviser who can help you with your investment plan.

## Did you know?

There is a wide range of companies listed on ASX, from household-name companies that provide the goods and services used by almost all Australians, to small, little-known companies that are just starting as a listed company. Some of these may do well, others may not.

## TIP

Fixed interest securities are generally regarded as lower risk/lower return than equity securities. It is important, however, for investors to think not just about the type of investment in which they invest their money, but also about how their money is used. For example, when making a decision to invest in debentures, don't just think about the rate of return, but also consider the risk of the investment, including the issuer's ability to pay the promised rate of return now and through to the maturity date and how your money is used, such as for property development. For more information about investment risk, see page 22 of this booklet.

### FIXED INTEREST (ALSO KNOWN AS DEBT SECURITIES)

Fixed interest securities are a financial instrument that signifies that someone owes you something. These securities represent loans to borrowers, such as governments, banks or other companies, who may be financing investment projects. Debt securities include bonds, loans and commercial paper; and are issued with maturities greater than one year.

For example, fixed interest securities involve you lending your cash to a debt issuer that promises to pay a rate of interest (the 'coupon rate') on a regular basis on the value of the loan (the 'face value'). On a specified date (the 'maturity date'), you receive the face value of the security and the final interest payment.

Investment in fixed interest securities is very different from an investment in equity securities. A share owner shares in the fortunes of the company, and there is the risk that company earnings and therefore returns to shareholders may fluctuate. The return you make from a fixed interest security is predetermined. You don't receive more if the debt issuer performs very well, but neither do you suffer if the issuer performs poorly (unless the issuer performs so poorly that they default on their loan obligations).

The debt issuer gives the investor a certificate, or bond, as proof of the loan. Interest on bonds is usually paid every six months ('semi-annually'). The main types of bonds are corporate bonds, issued by companies, or treasury bonds, issued by governments.

The rate of interest paid depends largely on the credit rating of the issuer: Treasury bonds offer the lowest rate of interest, because they are seen as having the least risk. Corporate bonds offer a higher rate of interest, because there is a greater chance that the company could default on their loan obligations.

Another debt security is a 'floating rate note' (FRN). FRNs are similar to bonds, but they offer a variable interest rate, rather than a fixed interest rate.

'Debentures' are another form of debt security. It is important to understand that not all debentures are the same. Debentures are not secured by a physical asset or collateral, and are generally backed only by the creditworthiness and reputation of the issuer.

Other structured debt securities include collateralised debt obligations (CDOs), convertible notes and hybrid debt securities.

### INTEREST RATE MARKET

The interest rate market consists of the money market and the fixed interest market. The fixed interest market is the market where interest rate securities with a maturity date over one year are traded. These securities include Commonwealth Government bonds, corporate bonds, FRNs and certificates of deposit.

Like the money market, the fixed interest market is a wholesale market, with participants including banks, superannuation funds, insurance companies and large corporates. To invest in fixed interest securities, you are likely to put your money in a product offered by an issuer. For example, many managed funds include a percentage of fixed interest securities. The percentage of the investment held in fixed interest securities will depend on the investment option selected by the investor.

### WHO SETS INTEREST RATES?

The primary influence on the level of interest rates in Australia is the Reserve Bank of Australia (RBA). The RBA is Australia's central bank. It implements monetary policy with the aim of maintaining inflation within a target range. It does this by setting the overnight 'cash rate' at a level it considers appropriate. For example, if the RBA thinks that inflation is likely to rise, it acts to tighten monetary policy by restricting the supply of money and increasing the cash rate.



If the RBA wants to stimulate economic activity, it will ease monetary policy by increasing the supply of money and reducing the cash rate. The cash rate flows through to the lending and borrowing rates set by banks. For more information on the RBA, monetary policy and the cash rate, go to [www.rba.gov.au](http://www.rba.gov.au).

## WHAT IS THE ROLE OF CREDIT RATING AGENCIES?

Credit ratings are given by ratings agencies to help investors assess the creditworthiness of an issuer, and consequently the 'credit risk' of an investment.

The highest investment grade is AAA. The Commonwealth of Australia holds a AAA rating. When a company's bonds are given a AAA rating, this indicates that the company is considered to be very financially secure.

Ratings are broadly split between 'investment grade' and 'below investment grade'. 'Below investment grade' indicates a much higher level of risk that a borrower could default on their loan obligations.

**REMEMBER: The lower the credit rating, the riskier the investment.**

## PRICE VS. YIELD

The price of an interest rate security fluctuates as interest rates go up and down. It can also change if its credit rating changes.

For example, the face value of a bond is only payable to the bond holder at maturity. Before that time, the bond may trade higher or lower than its face value.

Because of this, capital gains or losses are possible if a bond is sold before maturity. This explains why managed bond funds can return significant capital gains or losses, despite the fact that the coupon rate paid on a bond does not change.

**REMEMBER: As interest rates rise, the price of a debt security or bond falls. As interest rates fall, the price of a debt security or bond rises.**

## Did you know?

Because institutional investors very often refuse to lend to borrowers rated below investment grade, such borrowers must offer a rate of return higher than the 'cash rate' or rate of return of investment grade debt securities in order to attract funds from other investors. These investments can be rewarding if everything goes smoothly, but there is the risk that investors may lose everything if the company or project fails.

## BEWARE!

You rely entirely on the financial strength of the company issuing a debenture. In recent years, there have been several high profile cases of issuers of debentures or unsecured notes defaulting on their loan obligations. As a result, investors have lost substantial sums of money. ASIC advises investors take extra care with debentures, unsecured notes and other interest-bearing investments offering higher than usual returns. You should always compare the rate of return with the rate available on other fixed interest investments, and ask who you are lending your money to. ASIC gives the guidance that anything offering more than 2% above established, comparable products is considered 'high return' and investments should be made cautiously.

## TIP

Some bonds or notes can be traded on the secondary market, just like shares. But, if you trade them you will make either a capital gain or a capital loss, depending on what you paid for them in the first place. Exchange traded bonds or notes are affected by the same factors that influence bonds and notes, including changes in interest rates, yield spreads and yield curves and can reduce in value because the 'credit rating' changes.

## TIP

Investors in listed property or real estate trusts gain an exposure to both the value of the real estate the trust owns and the regular rental income generated from the properties. Indirect property investment gives you the many advantages of property ownership without having to find the property or manage the property yourself. The fund manager selects the investment properties and is responsible for all maintenance, administration, rentals and improvements. Most property trust managers include properties across a diversity of geographic regions, lease lengths, and tenant types. Indirect property investment makes it easier for the average investor to get the benefits of diversification.

## PROPERTY

Property generally falls into one of the following categories:

- Residential property – the type of property most of us are familiar with, a place lived in by owners or tenants.
- Commercial property – property intended for use by retail or wholesale businesses. Examples include shopping centres, offices, hotels and petrol stations.
- Industrial property – property used for industrial purposes such as manufacturing. Examples include factories and warehouses.

Property has traditionally been a popular investment among Australians, with most of us aspiring to own our own home. If you're considering a direct investment in property, there are some important things to consider including:

- Location – usually cited by real estate agents as the most important of all.
- Deposit – to make a direct property investment you will likely need to have an upfront deposit.
- Transaction costs – direct property investment has high upfront transaction costs, including estate agent fees and government stamp duties.
- Tenants – investment properties usually need a tenant. You need to consider whether you'll manage the property yourself, or employ a property manager. Managing a property yourself can save agents' fees, but is time consuming.
- Outgoings – investment properties have ongoing costs. You'll have to pay Council rates, water rates, maintenance costs, and possibly strata levies.
- Liquidity – unlike shares, which can be easily traded on the stock market, selling a property can be more difficult and take longer. It is also not possible to sell just a part of your investment.

## PROPERTY MARKET

You can invest in property either directly or indirectly. Direct property investment means you purchase the property yourself. If you buy an apartment and rent it out to tenants, you are a direct property investor. Direct property investment by most private investors is in residential property, as it is beyond the reach of most individual investors to buy an office block or shopping centre.

Indirect property investment means that you don't hold the title to the property yourself. Instead, you own units in a fund or trust that pools your money with the money of other investors, and invests in a range of property. For example, popular indirect property investments are Real Estate Investment Trusts (REITs) (also known as Listed Property Trusts), unlisted property trusts and property syndicates. Listed property or real estate trusts are a significant part of the Australian stock market. One of the advantages of trusts is that you can invest in commercial and industrial property, something that is harder to do directly.

## BEWARE!

You may have seen advertising for seminars promising to give you the secrets of getting rich through property investment. Similarly, some property investment schemes, like mezzanine finance, claim to give you big returns. Consider carefully the risks involved with the investment, and most important – find out who your money is going to. If it sounds too good to be true, it probably is!

## OTHER TYPES OF INVESTMENTS

### MANAGED INVESTMENTS

A managed investment (also known as a collective investment or managed fund) is an investment where a professional fund manager pools the funds of a number of investors and invests in an asset or range of assets on their behalf. Decisions on whether to buy and sell assets in the fund are made by the fund manager, not the investor.

Some advantages of managed investments:

- By pooling your funds with other investors, you can participate in a much larger investment than you could manage on your own.
- You get the benefit of the investment skills and knowledge of experienced fund managers.
- Even if you have limited funds available, you can invest in a diversified portfolio of assets, including cash, shares, fixed interest, property, infrastructure and alternative investments.

Fund managers receive a payment for their service in the form of a fee charged to the fund and/or a percentage of the returns of the fund.

There is a huge range of managed funds available. Some funds specialise in one class of asset, for example, shares or fixed interest. Others invest across several asset classes. Some funds invest solely in Australia, whereas others invest globally.

Funds also vary in their investment style. Passive investors aim to replicate the performance of a nominated benchmark. Such fund managers are referred to as 'passive' managers. For example, a passive Australian equities fund may aim to replicate the performance of the S&P/ASX200 Index. Such an approach takes decisions out of the fund manager's hands. Their responsibility is simply to make sure that the fund's composition matches that of the index. However the index performs, so too does the fund.

On the other hand, active investors aim to outperform a specified benchmark. Such fund managers are referred to as 'active' managers and take overweight positions in assets they believe will do well, and take underweight positions (or avoid altogether) assets they believe will underperform. If their views turn out to be correct, the fund will do better than the benchmark. If they are wrong, the fund's performance will lag.

Funds may invest only in assets that meet certain criteria. For example, a fund manager of a socially responsible investment (SRI) fund evaluates investment opportunities not just on the basis of financial performance, but also according to certain social and environmental criteria.

Funds may use specially selected fund managers. For example, a multi-manager fund will operate under a combination of different investment styles and processes.

Funds may be listed on ASX or unlisted. Listed managed investments (LMIs) can be bought and sold in the same way as shares. Unlisted managed investments are offered directly by the product issuer or through an intermediary such as a financial adviser.

## TIP

Managed funds vary widely in terms of their underlying investments, investment strategy and fees and charges. You should read the fund's Product Disclosure Statement (PDS) to determine whether the fund is appropriate to your needs and circumstances.

## Did you know?

The fees charged by active fund managers are generally higher than those of passive managers, as you are paying for the skills and expertise of the manager. Whatever type of fund you are considering, you should always look at the return the fund produces after its fees and charges are deducted. The higher fees of the active manager may be justified if the manager is able to consistently outperform the benchmark.

## TIP

Planning for your retirement should form a central part of your overall investment plan. Since 'Choice of Fund' legislation was introduced in 2005, investors have had a much greater say in how their super monies are invested. It is important to be aware of what your current super fund offers you and how it is performing, so that you can be sure your retirement funds are working hard for you.

### SUPERANNUATION

For many people, superannuation will be their biggest investment (perhaps after the family home). Superannuation is a subject in itself. For more information about superannuation, read 'Smarter Super: Invest in your future and make the most of your retirement' booklet available as part of this range of publications. Freecall 1800 009 180 for a free copy.

Superannuation is a managed investment which operates to provide benefits for retirement. It has similar features to other managed funds, in that it pools the contributions of many investors to invest in an asset or range of assets. In addition, it must comply with the extensive rules that apply specifically to superannuation funds.

Contributions are made into the fund during your working life and invested on your behalf by the fund. The law requires your employer to pay a minimum percentage (currently 9%) of your salary into superannuation, known as the Superannuation Guarantee (SG). You can also make additional voluntary contributions to your super fund. Super funds that meet prescribed government standards are eligible for tax concessions.

### FOREIGN EXCHANGE

A foreign exchange rate is the rate at which one currency can be converted into another currency. For example, the Australian dollar/US dollar exchange rate describes the value of one Australian dollar in terms of US dollars.

FX or forex is traded on the foreign exchange market, which is the largest market in the world. Currencies are traded against each other 24 hours a day, five days a week.

The foreign exchange market is a professional market, with dealings taking place primarily between banks, financial institutions, large corporations and FX brokers.

As a private investor you are unlikely to invest directly in the foreign exchange market, however, many of your investments will be directly or indirectly affected by movements in exchange rates. For example, if you buy shares in a company that conducts business internationally and the exchange rate moves, this affects the profits of the company in terms of Australian dollars.

Changes in interest rates, too, are linked to exchange rates.

## Did you know?

Many people think of their superannuation as a single investment, when typically, like many other managed investments, the underlying assets are diverse. This means that people with super usually already have a diversified investment portfolio. In reviewing your overall investment mix, remember to take into account how your super monies are invested by your super fund. For example, if your super fund invests in a high percentage of international shares, you may want to consider diversifying your personal investments into other assets, such as domestic shares, cash or property.

## Did you know?

If you have units in a managed investment that has international underlying assets, these assets are exposed to exchange rate movements. It is likely that the fund manager will use a 'currency overlay', which is an investment technique to hedge the fund's exchange rate risk.



## ALTERNATIVE INVESTMENTS

Alternative investments are investments that don't fall easily into the common asset classes. These types of investments can be more complex, or may have been structured to have features of more than one type of asset. While these investments may be more complex, they are not necessarily higher risk. In fact, some are deliberately structured to have risk-reducing features.

The main thing is to be sure to understand how the product or investment technique works. Then you will be able to decide whether it is a suitable part of your investment portfolio.

There is a wide range of investments that can be considered 'alternative'. We will now take a brief look at two of these — derivatives and hedge funds.

## DERIVATIVES

Derivatives are so-called because they derive their value from some underlying asset. They usually involve the right or obligation to buy or sell the underlying asset. Derivatives include options, futures, warrants and contracts for difference (CFDs).

Some derivatives are traded in centralised markets. Other derivatives are traded in the 'over-the-counter' (OTC) market. This is a professional market where banks, corporate investors and other institutions deal directly with each other to structure deals that are tailored specifically to their needs.

While they are not as complicated as you might think, derivatives are probably not the most suitable type of investment for a first time investor. They are generally better suited to those who already have some experience in investing in shares. Once you have that experience, derivatives can be a good way to increase the returns from your portfolio.

Contrary to the popular view, trading derivatives need not be risky. In fact, derivatives can be used to reduce your exposure to risk. The primary use of derivatives is to hedge the risk of unfavourable movements in the price of the underlying asset.

For example, producers of commodities such as gold, wool or wheat can use derivatives to lock in the sale price of their goods ahead of time. This gives them protection against a possible fall in the price. Similarly, a superannuation fund that expects to invest funds in the stock market in six months time can lock in a purchase price today, to protect itself against a price rise.

The other use of derivatives is to speculate. Because they offer leveraged exposure, derivatives are attractive to speculators who are prepared to take on an increased level of risk with a view to making a larger profit. Using derivatives to speculate is a high risk investment, and should only be considered if you're an experienced investor with the financial capacity to handle such risks.

## HEDGE FUNDS

Hedge funds are a form of managed investment. These funds invest in a range of underlying assets, including derivatives, and use a variety of investment techniques, including short-selling and leverage.

Hedge funds usually aim for an absolute (positive) return in all circumstances, rather than simply aiming to outperform a specified benchmark. Hedge fund managers tend to be aggressive investors, using sophisticated investment techniques and quantitative tools, and often investing in volatile markets.

Most hedge funds are unlisted, so it is harder to keep track of the value of your investment on a daily basis. It is also usually harder to sell out of a hedge fund at short notice. You may be required to give a certain amount of notice before your investment can be liquidated.

Hedge funds often have restrictions on investment. For example, investors may be required to keep their money in the fund for a minimum period, or the initial minimum investment may be quite large. Because hedge funds are generally regarded as a relatively high risk investment, any investment in a hedge fund should probably only make up a relatively small proportion of your overall investment portfolio.

## TIP

If you are interested in investing in a hedge fund, you should read the Product Disclosure Statement (PDS) very carefully to make sure that the investments the hedge fund manager makes suit your 'risk profile'.

A stack of gold coins is positioned on a document. The document features a line graph with a fluctuating line. The word "caught" is visible in large, bold letters. The background is a light blue color.

## UNDERSTANDING RISK AND RETURN

There is a fundamental link between an investment's return and its risk.

'Investment return' is the amount of money your investment earns.

'Investment risk' is the variability of returns and the chance that your investment will return less than you expect, or your investment makes a loss leaving you with less capital than when you started, or your investment doesn't even keep up with inflation meaning it is worth less over time.

'Volatility' is the relative rate at which the price of an investment moves up or down.

Generally, the higher the potential returns, the greater the risk.

The smaller the potential risks, the lower the returns.

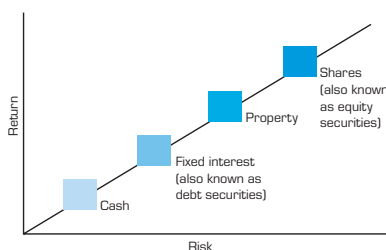
## RISK/RETURN TRADE-OFF

Successful investors understand the risk and return characteristics of their investments and their own 'risk profile'. For more information about understanding your 'risk profile', see page 7 of this booklet.

Different investors will weight their portfolios in different ways, depending on their investment goals and 'risk profile'. An investor who is aiming for capital growth over the long term, and who has the capacity to tolerate greater volatility and fluctuations in the value of their investments, may choose to include more higher risk/higher return investments than an investor who relies on their investments for a regular income. For example, shares in a speculative mining company may be quite volatile, with the share price moving considerably over a short period of time. On the other hand, residential property is usually less volatile, with property prices moving more gradually over a longer period of time.

It is important that you are comfortable with the volatility of your investments. Volatility with an investment can be reduced over time. If you make an investment for a longer period of time, then short term fluctuations in the value of your investment may not be too concerning for you. You should consider your investment time horizon when determining your 'risk profile' and identifying your investment strategy. If you expect to make high returns in a very short period of time, then you'll need to also accept very high risks. If you're prepared to take a longer term view, you can moderate the risk on your investment.

**Risk and Return Comparison**



The chart shows an investment rule of thumb: that cash is the least risky, but gives the lowest return over time, whereas, shares are the most risky, but should give you a higher return over time.

This rule of thumb is good to keep in mind, but you should also think not just about the risk characteristics of the asset class, but also other investment risks, including the market segment, the country of investment, the institution or company offering the investment and so on. The right investment mix for you will depend on your 'risk profile' and when you want to 'cash up' your investment.

## TIP

ASIC's FIDO website has a risk and return calculator that can help you compare the return offered by a proposed investment with the return of the relevant sector of the overall market. The calculator lets you judge the merits of an investment based on the type of investment matched to the yearly return expected and the years invested. See [www.fido.asic.gov.au](http://www.fido.asic.gov.au).

## Did you know?

If an investment offers returns that are appreciably higher than those offered by comparable investments, it is almost always because the investment carries higher risk. This is not to say that you should invest only in low risk investments. The important thing to remember is that your investment portfolio matches your 'risk profile'.

## INVESTMENT RISKS

No investment is risk-free. Some investment risks may be particular to the investment itself or to the particular asset class. Others may be much broader, for example relating to the country of investment or the economy in general.

**Economic risk (also known as systemic risk):** Risk inherent in the economy as a whole. In the event of an economic recession, the stock market, the interest rate market and the exchange rate market may all be adversely affected. Economic risk can arise due to recession, failure in prudential regulation or faults in the financial system. Economic risk affects the entire market.

**Market risk (also known as unsystemic risk):** Risk of volatility in a market or market sector. The 'tech boom' and subsequent 'tech wreck' in the United States in the late 1990s was an example of the risk of a particular market sector. Market risk doesn't affect the entire market.

**Inflation risk:** Risk that inflation will adversely affect the performance of your investment.

**Interest rate risk:** Risk that the value of an investment will change due to a change in interest rates. Changes in interest rates directly affect the value of interest rate securities, such as bonds. Interest rates also have an indirect effect on other investments, such as property and shares.

**Exchange rate risk:** Risk of fluctuations in exchange rates adversely affecting the value of an investment. A good way to diversify your investment portfolio is to invest overseas, but changes in the exchange rate of the Australian dollar against the currency of the country you invest in can affect the return of your investment.

**Liquidity risk:** Risk that an investment can't be easily and quickly converted into cash (bought or sold) at a fair price.

**Credit risk (also known as counterparty risk):** Risk that the counterparty to a contract will not live up to its contractual obligations.

**Political risk (also known as geopolitical risk):** Risk that a government will unexpectedly change its policies or implement new regulations, making an investment less attractive. Political risk can also refer to the uncertainty associated with investing in countries with a political climate less stable than our own.

**Sovereign risk:** Risk that a central bank will alter its foreign exchange regulations and reduce or null the value of foreign exchange contracts.

**Country risk:** Risk that a country won't be able to meet its financial commitments.

**Company risk:** Risk that the company you invest in fails and goes out of business.

**Institutional risk (also known as operational risk):** Risk of insufficient internal controls, failures in risk management systems, insufficient capital to absorb unanticipated losses, or inadequate governance structures. Institutional risk also refers to the financial standing of a financial institution or a company that invests money on your behalf. The level of institutional risk varies considerably depending on where you invest your money.

## TIP

Successful investors understand the risk and return characteristics of their investments, including the financial institution or company they invest with or in. The most important thing for you to know is who you're investing your money with, and satisfy yourself, as far as you can, that it is a reputable and well-run financial institution or company.

An investment technique that can help you better manage investment risk is 'diversification'. For more information about diversification, see page 24 of this booklet.

## Did you know?

Some investments are prudentially regulated. For example, some financial institutions, such as banks, are regulated by the Australian Prudential Regulation Authority (APRA). Investments with these institutions are generally safer, because these institutions must have in place strict operational arrangements. When you deposit money into an account or invest in one of their financial products you have assurances that the bank will look after your money. Other companies or institutions may not be subject to the same high regulatory standards. Prudential regulation does not mean your investment is guaranteed, but it is designed to reduce risk under all reasonable circumstances.





A woman with dark hair, wearing a dark blazer over a light-colored lace top, is shown from the chest up. She is holding a black mobile phone to her ear with her left hand and a pen over a document with her right hand. The document appears to be a form or a report with various fields and text. The background is a solid blue color.

## MANAGING YOUR INVESTMENTS

Once you have an investment plan and you have considered what investments will best help you to achieve your investment goals, you can start to think about other ways to get the most out of your investments.

### DIVERSIFICATION

'Diversification' is an investment technique that mixes different kinds of investments in a portfolio.

The rationale behind diversification is that the positive performance of some of your investments will offset the potential negative performance of other investments. For example, you can reduce economic risk and offset the risk of negative performance in domestic shares by investing also in international shares. Similarly, you can reduce exchange rate risk by spreading your overseas investments among different countries. You can also reduce institutional risk by spreading your investments across different asset classes, companies and fund managers. These techniques will limit the impact on your portfolio of an unfavourable movement in any one country, any particular currency or any particular asset class or investment.

The main thing to remember is the old saying: **Don't put all your eggs in one basket.**

### Did you know?

It is easy to see that if you hold shares in only one company, you are not diversified. But if you hold shares only in companies in one market sector; for example, mining companies, you are also not diversified. Effectively spreading your risk means investing not just in different companies or different sectors of the market, but in different sectors of the economy. You should consider your exposure to all asset classes.

The other key to managing your investment risk is to be as well informed as possible about the investments you hold. The more you know about the companies you invest in or the institutions that make investments on your behalf, the less likely you are to be exposed to risks you are unaware of.

## GEARING

'Gearing' is an investment technique that involves the investor using borrowed funds to invest.

A common form of gearing is a 'margin loan'. These loans are offered by financial institutions such as banks, and are often secured against the shares bought with the loan. Another form of gearing is when you borrow money to buy an investment property.

Gearing increases and magnifies the volatility of returns and losses. The attraction of gearing is that it increases the profit you can potentially make. There may also be taxation benefits if you use borrowed funds to buy an income producing asset. However, the risk is also increased, as you are required to pay off the loan regardless of how the investment performs. If the investment falls in value, not only are you left holding an asset that is worth less than you paid for it, but you must also service the loan you took out. For example, if the value of shares falls sufficiently, the holder of the margin loan will be required to either deposit more cash, known as a 'margin call', or sell a portion of the shares.

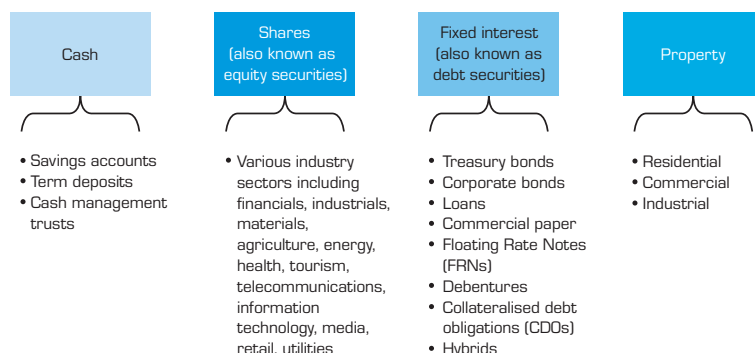
## TIP

Gearing can magnify profits, but it can also magnify losses. Gearing is probably best considered only when you have some experience as an investor. You must also be sure you have the financial capability to service the loan, and fully understand the risks involved.

## Did you know?

Using a margin loan to invest is a technique to leverage returns, usually used by people who already have investments. It should not be considered as a strategy for people who would otherwise be unable to afford to invest. A margin loan is only effective if the interest costs of the loan are more than offset by investment returns in the form of income and capital growth. A good investment must show a profit, not a loss!

**A diversified investment portfolio invests across the four asset classes.**



## TIP

A managed fund can be a good way to achieve diversification, especially if you have limited funds to invest. The fund will spread its investments among a range of assets. But remember, some funds may invest in one class of asset and this may restrict your ability to diversify. You should make sure that the underlying investments in the managed fund suit your 'risk profile'.

## COSTS OF INVESTING



The return from your investments is affected by the costs of holding the investment. Costs can be direct, such as fees or tax, or indirect, such as the opportunity lost by investing in an asset that didn't perform as well as another asset over the same period of time.

### INFLATION

The effect of inflation on your investment is unavoidable. If inflation is 2.5% per annum and the return on your investment is 7.5%, then the real or actual rate of return on your investment is 5% per annum.

### TAX

The rate of tax you pay will depend on the type of investment and your own personal income tax rate. For more information on tax, see page 9 of this booklet.

## TIP

Fees are part of how financial service providers are remunerated. Ask as many questions as you can about the fees and charges that will apply to your investments.

## FEES AND CHARGES

### ADVISER FEES AND COMMISSIONS

Financial advisers charge for providing financial advice to their clients.

Some financial advisers charge a flat 'fee-for-service', which means that the upfront cost of advice may be higher. Other advisers charge a commission, calculated as a percentage of investments you make through them. Depending on the size of your investment, you may be able to negotiate the size of the fee and when it is payable.

Financial advisers must disclose any fees or commissions, including those they may receive from the issuers of the financial products or investments they recommend. A Statement of Advice (SOA) or Record of Advice (ROA) will contain information about fees, commissions and other benefits. You should take into account fees, commissions or other benefits in evaluating whether the advice you receive is impartial.

Fees and commissions can vary, so it pays to shop around.

### PRODUCT FEES

Product issuers charge for manufacturing and administering the product.

Product issuers must disclose information about fees associated with the product or investment. Documents that contain information about product fees include a Product Disclosure Statement (PDS), prospectus or an alternative fees disclosure schedule.

(Note that a prospectus is published for shares only when they are first issued by the company in the primary market. If you buy shares on market, you will not receive a prospectus. Under the Continuous Disclosure rules, companies must keep the market fully informed on an ongoing basis.)

### FUND MANAGER FEES

Fund managers charge a fee for the management of your funds,

usually a percentage of your total investment. Some funds also charge a performance fee if the fund outperforms a specified benchmark.

### STOCK BROKER FEES

Stock brokers charge a fee, known as 'brokerage', for executing the purchase or sale of shares. It may be charged as a flat fee or a percentage of the value of the trade. Brokerage can vary. You will pay less for an execution-only service than if you require advice from the broker. The lowest rates of all are usually those offered by online broking services.

### WRAP FEES

Wrap accounts combine all your investments into one account. This can make managing your portfolio easier as you can buy and sell all your investments through the one manager, regardless of who ultimately provides the investment. A wrap account typically includes cash, shares and managed funds.

The benefit of a wrap account is that your investments are consolidated under one manager, reducing the amount of administration on individual investments. However, wrap accounts charge fees, so you must balance the cost of the wrap against the convenience of consolidating your investments.

### ASK YOUR FINANCIAL ADVISER:

- Do you have annual fees or are these one-off charges?
- Are these fees likely to increase or decrease in the future?
- Are there any other fees that might apply if I withdraw or switch investments?
- Do these fees apply before or after tax?
- What fees do you receive from the issuers of products you are recommending to me?



## AVOIDING MISTAKES

Investing doesn't have to be complex or confusing — investing simply means making your money grow in a smart way. Once you've spent a bit of time learning about investing, you've set some goals and you've started investing, you'll be surprised how quickly you can get up to speed and make the most out of your money.

When you invest your money rather than use it now, you are delaying consumption with the intention that by not using it now you will have more tomorrow. There are no guarantees with investing. Do what's right for you and don't let others pressure you into something that makes you feel uneasy.

Here are some tips to help you get the most out of your investments:

- **Do your homework.** Study about investing, follow financial discussions in the media, read newspapers and books, and seek out information from reputable websites. Think about the way global and national issues and events could affect your investments, now and in the future.
- **Pay off debt.** Put in place a budget to manage your day-to-day finances. You don't have to pay all debt off before your start investing, but be aware that every dollar that pays off debt is a dollar saved.
- **Stay balanced.** It's safer not to put all your eggs in one basket! Spread your investments over asset classes and investment time horizons. Diversification means that some assets may give higher returns and involve higher risk, but these are balanced by lower risk assets giving lower returns.
- **Stay calm.** All investment involves some level of risk and fluctuations in all markets are a natural thing. You have to have a little nerve and a lot of patience.



- **Be realistic.** Investment probably won't make you rich, but it will protect the earnings and the savings you and your family have made, well into the future. Good investment is usually a slow process, with small gains in the short term adding up to bigger gains over time. It's fine to set aside some of your money to speculate on bigger short term gains if that appeals to you, but don't be too aggressive with the majority of your money.
- **Compare potential returns.** The performance of your investments will impact on how much you have in the future. It's important that you make an informed decision about what investments suit your needs. Performance can be hard to judge. If you don't want to spend too much time buying and selling your investments, you could use interest-bearing investments as a measure. For example, if bank deposits are offering 6%, you should expect more for investments that are higher risk.
- **Seek advice.** A licensed financial adviser can match your 'risk profile' to a range of investment products. Be sure your adviser has an Australian Financial Services Licence issued by ASIC. Also make sure any investment scheme is registered with ASIC.
- **Ask about fees and charges.** Take into account the transaction costs with any investment decision. For example, ask how much commission the adviser is receiving from the product being promoted to you if they don't automatically disclose this to you.
- **Be prepared to sell.** Don't get attached to your investments, and if things aren't working out be prepared to sell before a loss becomes unsustainable.

- **Be sceptical.** Don't believe anyone who says they can give you consistently high returns without high risk. Even returns of 10% a year should be viewed with caution. Be cautious of anyone who guarantees future performance. Don't let yourself be talked into an investment if you don't understand what you are investing in.

ASIC's FIDO website has warnings and tips on how to spot scams, swindlers and investment pitfalls (such as investments offered over the phone or via email). This website also gives you information on how to conduct safety checks of known unlicensed overseas callers and make sure that the person you are dealing with holds an Australian Financial Services Licence as well as links to other useful websites. See [www.fido.asic.gov.au](http://www.fido.asic.gov.au)

## BEWARE: HOW TO SPOT A FINANCIAL SCAM

- 1 **It looks real:** Scams that catch people often look realistic and are presented professionally. They have attractive documents, a business-like website, and names that sound like reputable companies.
- 2 **Bigger and faster profits than real investments:** Scams always offer a higher return than genuine investments. Some offer 20% a year; others go for 300% a year or even more. It's too good to be true. By comparison, Australian shares are some of the most successful investments, and their value has grown about 7-9% p.a. over the long term.
- 3 **Less risk and less effort than real investments:** Most scams say that financial success is easy and risk isn't a problem. But real wealth demands planning, hard work and guts. Even the best investors make mistakes and have to weather storms like market busts and economic recessions.
- 4 **Something special that genuine investments don't offer:** It could be a 'secret' offer, 'inside information' or 'new techniques' to make you feel like you've got an edge over other people. But chances are it's a fairytale - and it won't have a happy ending.
- 5 **More urgent than the real thing:** Scammers often say 'don't miss out' and 'act quickly before it's too late'. They're really just trying to grab your money before you have a chance to check properly.

Source: ASIC's FIDO website at [www.fido.asic.gov.au](http://www.fido.asic.gov.au)



## WHERE TO GO FOR MORE INFO

There is an enormous amount of information available on investing. It is important to do your homework. There are a number of government, banking and finance sector resources to help you better understand investing including:

- Australian Bankers' Association provides free information about banking and financial services in the ABA's Financial Literacy Info Centre at [www.bankers.asn.au/financialliteracy](http://www.bankers.asn.au/financialliteracy) or call 1800 009 180
- ASX provides a range of free online courses as well as free educational materials. You can also find out how to set up and conduct an investment club. Go to the First-time Investors section of their website at [www.asx.com.au/investor/first\\_time/index.htm](http://www.asx.com.au/investor/first_time/index.htm)
- ASIC's FIDO website provides free information on investing, such as the booklet 'Getting Advice: A practical guide to personal financial advice', which contains useful information about getting professional financial advice. The website also contains other useful consumer tips at [www.fido.asic.gov.au](http://www.fido.asic.gov.au) or call 1300 300 630
- Financial Literacy Foundation's 'Understanding Money' website provides free information on a number of financial topics, including how to prepare budgets, set financial goals and develop a savings habit at [www.understandingmoney.gov.au](http://www.understandingmoney.gov.au)
- National Information Centre on Retirement Investments provides free, general investment and financial planning information. NICRI's website also contains the MoneyMap tool to assist you work out loan, investment and savings scenarios at [www.nicri.org.au](http://www.nicri.org.au)

These online resources can also be made available to you in hardcopy by contacting the relevant organisation.

### GETTING EXPERT ADVICE

A financial adviser can help you devise and put in place an investment plan that suits your circumstances. Take the time to find an adviser that meets your needs and importantly, make sure the adviser is licensed to provide financial advice to you!

Some places to go for advice include:

- **A financial adviser.** The law requires financial advisers to be licensed to provide financial product advice. You should only deal with an adviser licensed by ASIC.  
A licensed financial adviser is required by law to consider your investment objectives, financial situation and needs before giving you financial advice. This gives you confidence that the products and strategies recommended to you should be suitable.  
Good advice from an experienced, well-informed financial adviser can help you save money, focus on your short and long term financial goals and identify investments appropriate to those goals.
- **Your bank.** This can be a good place to start when you are first considering your investment options. Your bank will have people you can talk to and information about the choices available.
- **An accountant.** They can discuss the taxation aspects of investing, and help you to structure your investments in a tax effective way. Depending on the investments you choose, you may decide to use an accountant to help with ongoing personal income tax.

Regardless of the advice you take, you should still try to inform yourself as well as possible about your investments. It is important to assume responsibility for your own investing, as well as taking guidance from professionals.

### FINANCIAL ADVICE CHECKLIST:

- Only talk to a licensed financial adviser or their authorised representative
- Do your homework, read up and learn the basic investment concepts
- Write down the questions you want to ask the adviser before you first meet
- Ask what services the adviser offers
- Take notes while the adviser is speaking and ask for copies of any information they might have – remember to read the disclosure documents
- Ask the adviser if they are connected or affiliated to any financial institutions
- Ask the adviser how they are paid for their advice
- If you are not comfortable with the advice, say so.

## GLOSSARY OF TERMS

### AFSL

An Australian Financial Services Licence (AFSL) is issued by the Australian Securities and Investments Commission (ASIC) under section 913B of the Corporations Act, which authorises a person who carries out a financial services business to provide financial services, including issuing of a financial product or giving of financial product advice.

### APRA

The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the Australian financial services industry. It supervises banks, credit unions, building societies, insurance companies and regulated superannuation funds.

### Asset

An asset can be a physical asset, such as property, or a financial asset, such as bonds or shares. There are four main asset classes for investment products – cash, shares, fixed interest and property.

### ASIC

The Australian Securities and Investments Commission (ASIC) is the independent Australian government body that enforces and regulates company and financial services laws in Australia to protect consumers, investors and creditors. ASIC reports to the Commonwealth Parliament, the Treasurer and the Parliamentary Secretary to the Treasurer.

### Broker

An individual or firm which acts as an intermediary between a buyer and seller, usually charging a fee or commission for their service. In Australia, brokers must hold an AFSL.

### Brokerage

Fee charged by a stock broker, usually either a flat fee or a percentage of the value of the trade.

### Capital gain/loss

The difference between what you paid for an investment and how much you made when you sold it. A capital gain is taxable, and the tax payable is known as capital gains tax (CGT).

### Cash rate

The cash rate is the rate charged on overnight loans between financial intermediaries.

### Commission

A fee payable to a financial adviser or broker usually calculated as a percentage of investments.

### Compound interest

Interest that is calculated not only on the initial principal amount, but also on the accumulated interest. Compound interest is different to simple interest which is only calculated as a percentage of the principal amount. Compounding is where the value of an investment increases exponentially over time.

### Contract note

A record of an agreement between two parties to trade. A contract note contains details of a share purchase or sale.

### Coupon rate

Also known as a coupon yield, the interest rate stated on a debt or fixed interest security expressed as a percentage of the face value (or principal).

### Debenture

A debt security involving the long term lending of money for a return.

### Derivative

A financial instrument that derives its value from some underlying asset, such as a share price index or bond.

### Diversification

An investment technique that spreads investments over different assets, asset classes or fund managers, in order to reduce the total risk of an investment portfolio. The rationale is that a portfolio of different investments will, on average, provide a higher return and lower risk than any individual investment within a portfolio.

### Dividend

Payment made to the shareholders of a company out of profits made by the company.

**Equity**

The difference between what you owe and the value (on today's market) of what you own. Negative equity means you owe more than the total value of what you own.

**Face value**

The nominal dollar amount of a security when issued. For example, the face value of a debt security is the amount repaid to an investor when the bond matures.

**Financial adviser**

Also called a financial planner; provides individuals with personal advice on investments. A licensed financial adviser is obliged under the law to act in the interests of their client when making recommendations to their client.

**Financial Services Guide (FSG)**

A document required by the law that is given to a retail client when they are provided a financial service by a holder of an AFSL. The document describes the financial service being given and gives details of the provider.

**Fund manager**

An individual or firm responsible for making decisions related to a portfolio of investments in accordance with the stated investment objectives of the fund.

**Gearing**

Borrowing money to use to buy investments.

**Hedge**

An investment made to reduce the risk of adverse price movements in another investment.

**Hedge fund**

A type of managed investment that uses specialised and advanced investment techniques, such as leverage, derivatives and short selling, with the goal of producing higher returns.

**Imputation credit**

When an Australian resident shareholder receives a dividend, they may also receive an imputation credit for tax already paid by the company. The shareholder's tax liability can then be reduced by the amount of the tax credit. Also known as franking or dividend imputation.

**Intermediary**

A third party or 'middleman' who facilitates a transaction between two other parties.

**Income**

Money you receive in the form of your salary or wages, interest from bank accounts, dividends from shares, and rent from an investment property.

**Inflation**

The increase in the prices of goods and services in the economy.

**Interest**

The price of money. The price a bank charges for the money it lends you, or the return you get for the money you lend someone else.

**Investment**

Using your money to make it grow, for example, by buying property or shares.

**Investment grade**

A bond that has been rated by a credit rating agency as having a rating of BBB or above.

**Investment strategy**

Sometimes called an investment style, a method of managing allocation of assets within an investment portfolio reflecting the 'risk profile' of the investor. For example, a "balanced" investment technique aims to balance the risk and return of the investment and is suitable for investors with a longer investment time horizon.

**Investor**

An individual who commits money to, or purchases, an investment product with the expectation of future returns.

### Liquidity

The ability to convert an asset into cash quickly and without any price discount.

### Managed fund

A type of investment that pools the assets of many investors into a single fund.

Usually the investors have a common investment objective and strategy.

Managed funds include property trusts, share funds and cash management trusts.

### Negative gearing

Where an investment is made using borrowed funds, and the income, such as rental or dividend income, after the deduction of expenses, is less than the interest on the borrowed funds in a financial year.

### Over-The-Counter (OTC) market

A market where securities or other financial products are traded directly between participants, rather than in a centralised marketplace.

### Product Disclosure Statement (PDS)

A document required by the law that is given to a retail client to describe the main features of a financial product being issued or sold.

### Portfolio

A collection of investments owned by the one investor.

### Return

The amount of money your investment earns.

### Risk

The possibility that your investment may fall in value or earn less than expected.

### Risk profile

Your tolerance to investment risk.

Potential return rises with an increase in risk. Investments with low risk (lower levels of volatility or uncertainty) are usually associated with lower returns, whereas investments with higher risk are associated with potentially higher returns.

### Securities

Instruments of financial value that can be transferred from one party to another. Examples include shares, bonds and bank bills.

### Statement of Advice (SOA)

A document required by the law that is given to a retail client when they are given personal financial advice by a holder of an AFSL or their representative.

### Stock broker

A person, company or online entity that enables trading in shares and other types of securities.

### Superannuation

An investment which operates by putting aside money during your working life so you have a payment or income stream upon retirement. Superannuation funds that meet prescribed Government standards are eligible for tax concessions.

### Term deposit

An account that offers a higher rate of interest, but locks your money away for a set period.

### Volatility

The relative rate at which the price of an investment moves up or down. If the price of an investment moves up and down rapidly, it is said to have high volatility. Conversely, if the price of the investment never or rarely changes, it is said to have low volatility.

### Wrap account

An account that consolidates all your investments into the one account in order to make it easier to manage them.

### Yield

The annual rate of return on an investment expressed as a percentage.







## Other booklets in the ABA's financial literacy booklet series



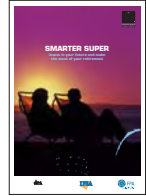
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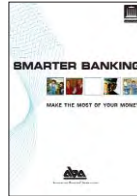
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Make the most of your money

## How to order other booklets

The Australian Bankers' Association (ABA) has prepared a number of other financial literacy booklets. If you would like to obtain copies, please contact the ABA.

## How to order this booklet

This booklet has been prepared by the Australian Bankers' Association (ABA) with the support of the Australian Financial Markets Association (AFMA) and the Australian Securities Exchange (ASX). If you would like to obtain additional copies, please contact the ABA or AFMA.



AUSTRALIAN BANKERS' ASSOCIATION INC.

### **Australian Bankers' Association Inc.**

The ABA is an industry association that represents Australia's banks. The banking industry is committed to helping Australians better understand financial services to make more informed choices when it comes to managing money and every day finances.

The ABA website has a Financial Literacy Info Centre which provides information on managing your money, ways of banking, banking products and services, and protecting your money and banking information.

#### **CONTACT US**

#### **Australian Bankers' Association**

**Freecall:** 1800 009 180

**Email:** [reception@bankers.asn.au](mailto:reception@bankers.asn.au)

**Website:** <http://www.bankers.asn.au>



### **Australian Financial Markets Association**

AFMA represents firms providing products and services to the wholesale financial markets in Australia.

AFMA's members provide financial products and services that help Australians to build and manage their wealth.

#### **CONTACT US**

#### **Australian Financial Markets Association**

**Tel:** (02) 9776 7955

**Website:** <http://www.afma.com.au>



### **Australian Securities Exchange**

The Australian Stock Exchange was formed in 1987 through the amalgamation of six independent stock exchanges that formerly operated in the state capital cities.

In 2006, the Australian Stock Exchange merged with the Sydney Futures Exchange to form ASX.

ASX helps listed companies raise capital, provides opportunities for investors to build their wealth and enables buyers and sellers to transact with confidence.

#### **CONTACT US**

#### **Australian Securities Exchange**

**Tel:** 131 279

**Website:** <http://www.asx.com.au>

