

A guide to investing in shares

When you buy shares, you become a part-owner of a business listed on the stock exchange. As a part-owner, you will receive a proportion of the profits (dividends), and you will benefit from any growth in the share price.



The sharemarket is a place where people can buy and sell shares, and where companies can raise capital by issuing shares to investors.

You can invest in shares directly, or via a managed investment or separately managed account. With a managed investment or separately managed account, the investment manager researches the shares and buys and sells on your behalf (as well as for all the other investors in that fund).

Conversely, if you directly invest in shares, you have total control over what you buy and sell. However, this means that you will need to research and manage those shares yourself (unless, of course, this is done for you by your financial adviser).

Why should you invest in shares?

The primary reason for investing in the sharemarket is that quality shares almost always outperform the other asset classes (ie property, cash and fixed interest) over the long-term.

As you can see from Graph 1, a \$100,000 investment in the All Ordinaries Accumulation Index 12 years ago would have grown to more than \$300,000, assuming dividends were re-invested.

This is a substantially better result than those achieved by most other asset classes.

How risky are shares?

There are two main types of risk associated with shares. Both can be managed.

The first is that the price of a particular share can fall suddenly and dramatically.

This risk can be minimised by investing not just in one share, but in a number of shares, so that if one share does fail, the value of your overall portfolio will only be affected to a small degree.

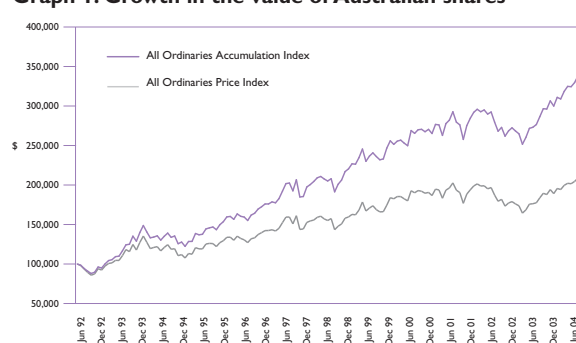
This is known as diversification.

The second risk is that the sharemarket in general can experience strongly fluctuating returns. While this can be nerve-racking, the sharemarket has always recovered its value over the medium-term. Graph 1 shows the movements of the All Ordinaries Index over the past 12 years. As you can see, although the market fluctuates, the long-term growth is strong. It's important to ride out any ups and downs and avoid panic selling when the market is at its lowest point.

Graph 2 shows the percent return of the All Ordinaries Accumulation Index over five year periods. You will notice that the index delivered an average 5-year return of 12.23% to investors over the 15-year period.

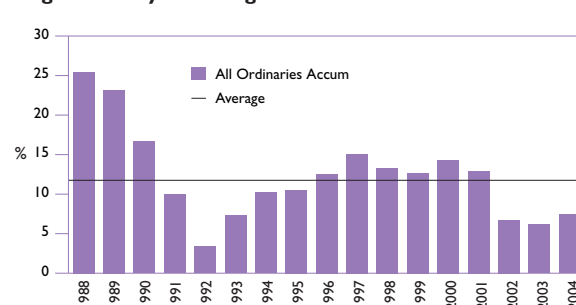
Despite their volatility, shares are a far better long-term investment than other 'low-risk' asset classes. Graph 3 shows the difference in the long-term returns of investing in term deposits compared with industrial shares. As you can see, the income and capital value generated from the share portfolio vastly outperforms that of the term deposits.

Graph 1: Growth in the value of Australian shares



Source: St.George Investment Solutions

Graph 2: Shares can be volatile but perform well over the long term – 5 year rolling returns



Source: St.George Investment Solutions

Choice

Why do share prices rise?

The share prices of businesses listed on the stock exchange generally rise because of prudent financial management by the directors of the company. When the company makes a profit, not all of it is distributed to investors as dividends. Part of the profit is usually retained by the company to re-invest back into the business, (eg to buy better technology in order to create efficiencies, or to buy other businesses, or to break into new markets). If this is done well, the business will generate bigger profits than before. And, once again, part of these profits will be retained by the business, leading to greater profits again.

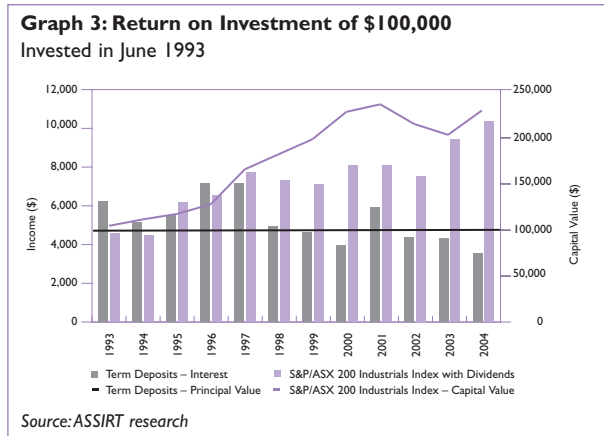
So, over time, the value of the company increases, and this is recognised by investors who buy more shares, thus increasing the share price.

In addition, the dividends also increase, and this, too, has a positive effect on the share price.

What is the dividend imputation system?

Many listed companies pay tax on their profits before dividends are distributed to you. In other words, those dividends come to you 'tax paid'. Your personal tax liability is then calculated after taking into account the tax that has already been paid by the company. The objective is

to ensure that the dividends are not over-taxed. As a result, investors on the top marginal rate of 48.5% pay little tax on 'fully franked' dividends, while investors on lower tax rates either pay no tax on the dividend or qualify for a tax refund.



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