

Life Matters

What are Shares?

Many people who have never owned shares or had anything at all to do with them do not understand how they work and therefore they are reluctant to buy them. The following is a simple explanation as to what a share actually is.

When you buy shares, also known as equities or stocks, you literally become a part-owner of the business. If, for example, ABC Company has 100,000 shares worth \$1 each and you buy \$1,000 of shares, you own 1% of that company.

Companies do not have to list on the stock market to issue shares. Many businesses start life with friends and family as shareholders. These businesses are called unlisted companies. However this article relates to companies listed on the Australian Securities Exchange (ASX).

There are more than 1200 companies listed on the Australian Securities Exchange and the top 200 are known as blue chip shares or the **ASX 200**. They include such household names as Woolworths, BHP and Telstra.

As a shareholder you have a say in the company's affairs by voting at company meetings and, of course, the ability to share in its fortunes. If the company does well, the value of your investment should rise but if it does badly, you could see your shares fall in value.

What are the benefits of share ownership?

There are two ways you can benefit from owning shares. The first way is through the growth of the company. Say, for example, ABC Company earns revenue of \$100,000 in one year. After deducting its costs, it has \$50,000 left – **its profit**.

It then reinvests this money in the business, perhaps by investing in better technology, which enables it to cut costs and, therefore, make a bigger profit the following year. If it can continue to improve its profits, demand for its shares will grow and the share price will rise. This type of company is known as a **growth stock** and it is often popular with investors who do not need an immediate income from their investments.

Many companies also pay a dividend. Say, for example, XYZ Company earns revenue of \$100,000. After deducting its costs and reinvesting in the business it has \$10,000 left over. It decides to return this money to shareholders by paying a dividend. If the company has 100,000 shareholders, each share will get a dividend of 10 cents per share. So, if you own 100 shares, your total dividend will be \$10. If the company is an Australian company in most cases the company will have also paid up to 30 cents in the dollar tax to the government before you received your dividend so that in this case your dividend would also come with a \$4.28 cent tax credit as your share was fully franked. That \$4.28 credit can be written off against the tax on other income you may have earned or returned to you as a tax refund by the taxation department.

Shares that pay dividends are generally known as **income** stocks. Companies can return money to shareholders in other ways too, such as buying back their shares thus increasing the value of those shares still in circulation.

By investing in shares you are also linking your financial wealth to the health of Australian and overseas economies. The proportion of goods and services sold in Australia for example typically rises when the economy is growing and falls when the economy is not growing (a recession) thus affecting company profits. The fact is that our economy spends longer in growth periods than in recessions and this has helped our shares produce better returns than most other assets and, crucially, beat the effects of inflation.

Why invest in shares?

Quality shares not only tend to rise over the long term, they usually outperform other investments and that alone is a great reason to make shares an integral part of your investment portfolio.

Every so often however the share market does make the front page of the newspaper because something has gone wrong such as the current Sub Prime crisis and the prices of shares fall in value. In this decade investors experienced the collapse of a price "bubble" in high-tech shares, plus sharp falls associated with the September 11 terrorist attacks, wars in Iraq and numerous other crises.

What you never see reported on the front page however are all those unspectacular 0.5%, 1% or 2% gains that gradually push the share market higher and higher and that is how long term investors make their money.

Taking profit from shares?

The other interesting thing about quality shares is their liquidity. For example if you started your investment with \$100,000 and after a period your investment had gone up in value to \$110,000 you can access the profit of \$10,000 without selling the whole investment - thus limiting the amount of capital gains tax you would be liable to have to pay.

Which shares to buy?

It is possible to invest in the top 200 companies in Australia (ASX 200) in exactly the right proportions with as little as \$1,000 using an Index Fund. That means that there is no selection of shares for you to make. You have **ALL** the top 200 shares.

Index fund investing also allows for huge diversification within a portfolio, which historically is better for your bottom line.

Index Funds also outperform many fund managers, stock brokers and so called stock picking experts and they have the added advantage of a lower cost base with much fewer transactional costs resulting in greater tax benefits to you.

Keeping track of a share index investment?

Keeping track of your investment in Index Funds can be as easy as watching the news each night. If the ASX 200 has gone up by 1% then your investment has also gone up - or visa versa.

At 6pm on Tuesday 4th March we are giving a FREE investment workshop that explains how you can make money by simply investing in an Index Fund. If you would like to attend you should ring Cathy on 5445 6044 to reserve your seat as seating is limited. The workshop is expected to go for approximately 3 hours with a refreshment break at half time.

In the words of Warren Buffett (the world's most successful share market investor):

"The best way to own common stocks is to own an Index Fund that charges minimal fees."

Julie Schafer



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The above advice is general in nature and readers should seek their own expert advice before making financial decisions based on this article.

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