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- Understand the markets
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**David Stevenson**

*Author and Financial Times columnist*

**Paul Mladjenovic**

*Certified financial planner and investment consultant*



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# *Investing in Shares*

FOR

**DUMMIES<sup>®</sup>**

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**by David Stevenson and Paul Mladjenovic**

 **WILEY**

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# Dedication

For my beloved Fran, Adam, Joshua, and a loving, supportive family, I thank God for you.

I also dedicate this book to the millions of investors who deserve more knowledge and information to achieve lasting prosperity. – Paul Mladjenovic

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# Introduction

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**H**ouses, gold, tulips . . . our idea of what constitutes a good ‘investment’ has changed dramatically over time but one precious, valuable idea still holds true: that shares over the long term have been a great investment and have without doubt made their intrepid ‘holders’ returns of between 5 and 7 per cent per annum over many decades. Obviously that optimistic assessment requires a huge caveat, perhaps even a flashing warning sign of epic proportions, loudly proclaiming that investing in shares can be a roller-coaster ride! Anyone piling their hard-earned fortune into the stock market in 2007 would soon have realised that shares (also called equities or stocks) can be hugely volatile and that you can lose your money almost overnight. Remember the dark days of early winter 2008, when the financial markets stood on the edge of catastrophe and shares were plunging by 5 per cent one day and 10 per cent the next? Scary stuff, but within 12 months the markets had staged a remarkable recovery and some stocks – especially those of the big banks – had more than trebled in value. The moral of the story is simple: investing in shares can sometimes be fun, often risky, but also frequently rewarding, especially if you are patient, careful and diligent. This book can definitely help you avoid the mistakes others have made and can point you in the right direction.

Explore the pages of this book and find the topics that most interest you regarding the world of share investing. Understanding what not to do can be just as important as working out what to do. The single difference between success and failure, between gain and loss, boils down to one word: knowledge. Take this book as your first step in a lifelong learning adventure.

## *About This Book*

No-one knows anything in the paranoid world of investing. Every day experts traipse onto our TV screens to discuss where ‘the markets’ might go tomorrow . . . or next week . . . or even next year. Trust us when we say that it’s all hocus pocus – no-one knows anything for sure. In fact, you might have a better handle on what really matters in the global markets than the ludicrously overpaid hedge fund maestro sitting in his office in Mayfair. Stock markets are a volatile brew of common sense, wisdom based on decades of experience of ‘what works’ and an inkling of the ebb and flow of human

emotion. Master these criss-crossing currents and you might just build a sensible investment portfolio. Hopefully this book will help you navigate these stormy, ever-changing waters.

This book is designed to give you a realistic approach to making money by investing in shares. It provides the essence of sound, practical share investing strategies and insights that have been market tested and proven from nearly a hundred years of stock market history. We don't expect you to read it cover to cover, although we'll be delighted if you read every word! Instead, this book is designed as a reference tool. Feel free to read the chapters in whatever order you choose. You can flip to the sections and chapters that interest you or those that include topics that you need to know more about.

*Investing in Shares For Dummies* is also a book that is quite different from the 'get rich with shares' titles that have crammed the bookshelves in recent years. It doesn't take a standard approach to the topic; it doesn't assume that shares are a sure thing and the be-all and end-all of wealth building. At times in this book, we tell you *not* to invest in shares. This book can help you succeed not only in up markets but also in down markets. Bull markets and bear markets come and go, but the informed investor can keep making money no matter what. To give you an extra edge, we have tried to include information about the investing environment for shares.

## *Conventions Used in This Book*

To make navigating through this book easier, we've established the following conventions:

- ✓ *Italic* highlights new terms that are defined.
- ✓ `Monofont` is used for web addresses.
- ✓ Sidebars, shaded grey boxes of text, are filled with interesting information that isn't pertinent to your understanding of the topic, but is interesting nonetheless.

## *What You're Not to Read*

Sidebars (grey boxes of text) in this book give you a more in-depth look at a certain topic. While they further illuminate a particular point, these sidebars aren't crucial to your understanding of the rest of the book. Feel free to read them or skip them. Of course, we'd love for you to read them all, but our feelings won't be hurt if you decide to skip over them.

The text that accompanies the Technical Stuff icon can be passed over as well. The text associated with this icon gives some technical details about share investing that are certainly interesting and informative, but you can still come away with the information you need with or without reading this text.

## *Foolish Assumptions*

We reckon you've picked up this book for one or more of the following reasons:

- ✔ You're a beginner and want a crash course on share investing that's an easy read.
- ✔ You're already a share investor, and you need a book that allows you to read only those chapters that cover specific share investing topics of interest to you.
- ✔ You need to review your own situation with the information in the book to see if you missed anything when you invested in that hot share that your sister-in-law recommended.
- ✔ You need a great gift! When Uncle Fred is upset over his poor share picks, you can give him this book so he can get back on his financial feet. Be sure to get a copy for his broker, too. (Odds are that the broker was the one who made those picks to begin with.)

## *How This Book Is Organised*

The information is laid out in a straightforward format. The parts progress in a logical approach that any investor interested in shares can follow very easily.

### *Part 1: The Essentials of Share Investing*

This section is for everyone. Understanding the essentials of share investing and investing in general will only help you, especially in uncertain economic times. Shares may even touch your finances in ways not readily apparent. For example, shares are not only in individual accounts; they're also in unit trust funds, pension plans and even SIPPs (self-invested personal plans to the uninitiated).

An important point is that shares are really financial tools that are a means to an end. Investors should be able to answer the question, ‘Why am I considering shares at all?’ Shares can be a great vehicle for wealth building, but only if investors realise what they can accomplish and how to use them.

One of the essentials of share investing is understanding risk. Most people are clueless about risk. Chapter 4, on risk, is one of the most important chapters that serious share investors should read. You can’t avoid every type of risk out there. (Life itself embodies risk.) However, this chapter can help you recognise it and find ways to minimise it in your share investing programme.

## *Part II: Before You Start Buying*

Once you’re ready to embark on your career as a share investor, you’ll need to use some resources to gather information about the shares you’re interested in. Fortunately, you live in the information age. We pity the investors from the 1920s, who didn’t have access to so many resources, but today’s investors are in an enviable position. This part tells you where to find information and how to use it to be a more knowledgeable investor (a rarity in recent years!). For example, we explain that shares can be used for both growth and income purposes, and we discuss the characteristics of each. See Chapters 8 and 9 for more information.

When you’re ready to invest, you’ll invariably have to turn to a broker. Several types exist, so you should know which is which. The wrong broker could make you . . . er . . . broker. Chapter 7 helps you choose.

## *Part III: Picking Winners*

Part III is about picking good shares using a good old-fashioned technique called focusing! Cast aside those big questions about the direction of the world economy or the ebb and flow of inflation and focus instead on the individual shares of companies. In this part of the book we explain how to evaluate a company’s products, services and other factors so that you can determine whether a company is strong and healthy.

We put a lot of emphasis on a simple idea: investing in companies with a potentially bright future ahead of them. If we can steer you toward those segments of the stock market that show solid promise for the coming years, then that alone would make your share portfolio thrive. Putting your money into solid companies that are in thriving industries has been the hallmark of superior share investing throughout history. It’s no different now. Check out



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Chapter 13 if you want to know more about this idea of identifying ‘quality’ companies with decent growth prospects.

Where do you turn to find out about a company’s financial health? In Chapter 11, we show you the documents you should review to make a more informed decision. Once you find the information, you’ll discover how to make sense of that data as well. While you’re at it, check out Chapter 12 (on analysing industries).

We compare buying shares to picking goldfish. If you look at a group of goldfish to choose which ones to buy, you want to make sure that you pick the healthiest ones. With shares, you also need to pick companies that are healthy. Part III can help you do that.

## ***Part IV: Investment Strategies and Tactics***

Even the shares of great companies can fall in a bad investing environment. This is where you need to be aware of the ‘macro’. If shares were goldfish, the macro would be the pond or goldfish bowl. In that case, even healthy goldfish can die if the water is toxic. Therefore, you need to monitor the investing environment for shares. Part IV reveals tips, strategies and resources that you shouldn’t ignore.

Once you understand shares and the economic environment in which they operate, you can choose the best strategy and tactics to help steer you to your wealth-building objectives. Chapter 17 reveals some of our all-time favourite techniques for building wealth and holding on to your share investment gains. (Definitely check it out.)

You may be an investor, but that doesn’t mean that you have deep pockets. Chapter 18 tells you how to buy shares with lower (or no) transaction costs. If you’re going to buy the shares anyway, why not save on commissions and other costs?

As an investor, you must keep an eye on what the company insiders are doing. In Chapter 19, we explain what it may mean if the company’s management is buying or selling the same share that you’re considering.

After you spend all your time, money and effort to grow your money in the world of shares, you have yet another concern: holding on to your hard-earned gains. This challenge is summarised in one word: taxes. Sound tax planning is crucial for everyone who works hard. After all, taxes are the biggest expense in your lifetime (right after children!). See Chapter 20 for more information.

We finish this section with a chapter that focuses on new developments within the world of investment. In Chapter 21, we look at new funds called ETFs, or tracker funds, as well-structured products and ask whether you might be better off following an index rather than picking an individual company share.

## *Part V: The Part of Tens*

We wrap up the book with a hallmark of *For Dummies* books – the Part of Tens. These chapters give you a mini crash course in share investing, including ten ways to protect yourself from fraud.

In this part, we offer some clues that signal a share price increase and how to recognise the warning signs of a share poised to fall. We also review the list of ten challenges and opportunities that face share investors.

## *Part VI: Appendixes*

Don't overlook the Appendixes. We pride ourselves on the resources we provide for our readers so that they can make informed investment decisions. Whether the topic is share investing terminology, economics or avoiding capital gains taxes, we include a treasure trove of resources to help you. Whether you go to a bookshop, the library or the Internet, Appendix A gives you some great places to turn to for help. In Appendix B, we explain financial ratios. These important numbers help you better determine whether to invest in a particular company's shares.

## *Icons Used in This Book*



This icon flags a particular bit of advice that just may give you an edge over other investors.



When you see this icon, we're reminding you about some information that you should always keep stashed in your memory, whether you're new to investing or an old pro.



Pay special attention to this icon because the advice can prevent headaches, heartaches and financial aches.



The text attached to this icon may not be crucial to your success as an investor, but it may enable you to talk shop with investing gurus and better understand the financial pages of your favourite business publication or website.

## *Where to Go from Here*

You may not need to read every chapter to make you more confident as a share investor, so feel free to jump around to suit your personal needs. Since every chapter is designed to be as self-contained as possible, it won't do you any harm to 'cherry-pick' what you really want to read. But if you're like us, you still may want to check out every chapter because you never know when you might come across a new tip or resource that will make a profitable difference in your share portfolio. We want you to be successful so that we can brag about you in the next edition!



# Part I

# The Essentials of Investing in Shares



'Congratulations, you are now a fully paid-up customer of a very successful stockbroking company & forgive me once again for not standing up.'

## *In this part . . .*

**M**any investors do things in reverse; they buy shares first and learn 'some lessons' afterwards. Your success is dependent on doing your homework before you invest your first pound in shares. Most investors don't realise that they should be scrutinising their own situations and financial goals at least as much as they scrutinise shares. But how else can you know which shares are right for you? Too many people risk too much simply because they don't take stock of their current needs, goals and risk tolerance before they invest. The chapters in this part tell you what you need to know to choose the stocks that best suit you.