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3rd Australian Edition

Getting Started in Shares For Dummies®

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Learn to:

- **Understand how the Australian sharemarket works**
- **Create a diverse portfolio with acceptable risk levels**
- **Choose the right broker for your investing needs**
- **Get to grips with the tax side of share investing**

James Dunn

Finance commentator

3rd Australian Edition

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by James Dunn

For Dummies
A Wiley Brand

Getting Started in Shares For Dummies®, 3rd Australian Edition

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Introduction

Thanks for choosing the third edition of this compact edition, *Getting Started in Shares For Dummies*. This smaller-sized edition is what's called a *portable* edition, full of information but small enough to carry on the tram, train or bus or to take with you on holidays for easy reading. This edition brings you up to date with the many exciting developments in the Australian stock market. If you're a first-time investor, this book has advice on where to start, the pitfalls to avoid and tips on how to have fun (and not take too many risks) while your money goes to work for you.

The global financial crisis (GFC) and the market slump that ensued — which has become one of the longest-lived the sharemarket has seen — has dented many investors' faith in shares as an investment, but despite the scary headlines and the ever-present possibility of a market fall, profitable companies continue to generate capital growth for their shareholders over the long term. The great paradox of the sharemarket is that while it's the most volatile of the asset classes, it's also the one most capable of reliably building wealth over the long term for the individual investor; I show you how in this book.

Australia has grown and developed in many directions since the first edition of *Getting Started in Shares For Dummies* welcomed investors taking their first steps into the sharemarket. If you followed the first edition (or indeed the second), you're hopefully now managing a portfolio, researching stocks that interest you, keeping abreast of the daily market play and boosting your initial investment to something that'll at least pay for your dream holiday and at best see you comfortably through the years.

In many of the speeches that I've made around the country in 28 years as a finance journalist, I've tried to present the sharemarket as a hugely interesting institution. Because it is! And, moreover, this market, which touches every one of our lives in one way or another, doesn't have to be daunting. The sharemarket isn't a hard concept to understand. When people say to me that I make the idea of buying and selling shares understandable for them, I curse whatever it was they'd been reading or hearing that made it appear the opposite.

About This Book

Getting Started in Shares For Dummies explains the sharemarket's intricacies in terms that anyone can understand. Although the sharemarket looks like a high-tech computer game with its flashing lights and scrolling letters and numbers on the trading screens, the sharemarket is actually based on a very simple concept. Companies divide their capital into tiny units called shares, and anyone can buy or sell these units in a free market at any time. Companies use the sharemarket to raise funds from the public, and the public — meaning you — invests in the companies' shares. You invest your money in shares because you expect to get a better return in earnings than with other investments.

Most of the time the sharemarket is profitable for investors. Despite the occasional spectacular market fall, such as the great 'bear market' of 2007 to 2009 — or even the odd collapse of one of its constituent companies — the sharemarket generally plods along making money for its investors. The sharemarket revolves around money, but is also very much a human institution. The sharemarket is sometimes described as a living entity (for which we finance journalists are often mocked). Oddly, the sharemarket does have human moods because it reflects the greed or fear of its users, who are sometimes *very* human.

Greed is a powerful influence on the sharemarket, and so is fear. A saying on Wall Street suggests that these two emotions are the only influences at work on the sharemarket, and they fight a daily battle for supremacy. On a day-to-day basis, the sharemarket wavers between the two. The 2000s began with the fear of the 'tech bust', and then switched firmly to greed for the middle part of the decade, only for fear to come roaring back into the spotlight in late 2007, and again in 2015. The two will always have their days on top.

The sheer range of activities of the companies listed on the Australian Securities Exchange (formerly the Australian Stock Exchange) makes it a very interesting place — if a trading system that you can see only on computer screens all over the nation can be called a place. The number of different types of shares you can invest in is mind-boggling — perhaps there is too much choice. As an individual investor, you can't own every type of share, so the solution is for you to come up with a share investment strategy.

As you will discover, of the 2,200 or so stocks listed on the Australian Securities Exchange (ASX), most investment professionals confine their activity to about one-sixth of them. Even in the 500 stocks that comprise the All Ordinaries Index (one of the Australian sharemarket's main indicators), the last 200 or so don't hold much interest to Australian fund managers. This is where a self-reliant investor like you can find some undiscovered gems caught in that bind of being too small to attract the fund managers' and brokers' attention, and then remaining small because they can't get this attention. Some of the sharemarket's acorns really do become great oaks. As a self-reliant investor, with the knowledge and the time to thoroughly research potential stock purchases, you can really steal a march on the pros.

It gets harder and potentially more rewarding the deeper you delve into the sharemarket. In the bottom 1,900 or so stocks, you may find some real dogs that should not be listed (and probably won't be for very much longer), but you can also discover wonderful companies that are just about to flourish. This kind of investing is called bottom-fishing. You need to be wary and know how to back up your discoveries with solid research. At these depths of the market, you can make some very wrong moves.

You have to own some of the 2,200 stocks in order to experience the ups and downs of the sharemarket. The tools that enable you to get into the market intelligently are right here in this book. The sharemarket should be an essential part of everybody's investment strategy. Sharemarket participation in Australia is among the highest in the world, but too many people still don't understand its benefits. As the nation's population ages and superannuation grows in importance, the amount of Australians' investment assets (and retirement nest eggs) going into Australian shares is set to rise dramatically. My aim in this book is to help you understand the sharemarket so that you can control your future financial security.

Foolish Assumptions

I don't assume a lot about you as a reader and budding share investor, but I do make these brief assumptions before I encourage you to get started:

- You are interested in knowing more about the sharemarket.
- You know some of the basics, but you'd like to flesh out this knowledge.

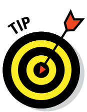
- You know that even if people don't think they're involved in the sharemarket, a big chunk of their superannuation certainly is!

Icons Used in This Book

Throughout this book you see friendly and useful icons to enhance your reading pleasure and highlight special kinds of information. The icons give added emphasis to the details that I think are extra important. Although the icons are self-explanatory, here are their basic messages.

Take extra special notice of this piece of information. I mean it, too — this detail is really something to store away for future use.

It's not vital that you read this stuff as you'll get a good understanding of the subject matter anyway. But it's often interesting and sometimes an entertaining diversion.



This is information I think you can profit from, so I've pre-highlighted it for you (I'm trying to save you from getting highlighter ink on the opposite page when you close the book).

Uh-oh! Wealth hazard ahead! Manoeuvre carefully around this obstacle, and mark it down in the memory bank.

Beyond the Book

This book also comes with a free access-anywhere Cheat Sheet that provides plenty of helpful share investing tips. To get this Cheat Sheet, simply go to `www.dummies.com` and search for 'Getting Started in Shares For Dummies Cheat Sheet' in the Search box.

Where to Go from Here

You don't need to read this book cover to cover, but if you're a beginner in terms of the sharemarket, starting at Chapter 1 is a good way to go. In fact, I hope you do. If you're not a beginner, then each chapter is written as a self-contained read, with plenty of cross-references to other chapters scattered throughout the book. If you want to know more about a particular topic, don't hesitate to follow the cross-references and gain a broader, fuller understanding of that particular topic.

I hope that after you go through this book — if you haven't already dipped your toe in the sharemarket waters — you'll want to take the steps to starting your first portfolio of shares. If you're already an investor — great! Now you'll want to become a better-informed and more effective investor. Work out for yourself what financial security means to you, sit down with a financial adviser (or not, if you prefer; but it is advisable) and decide how shares can help you achieve your goals. Then, get started. Today!

Part I

Putting the Share in Sharemarket

getting started in shares

In this part . . .

- See how the sharemarket builds wealth.
- Figure out the two functions of the sharemarket.

Chapter 1

So, You Want to Invest in Shares

In This Chapter

- Timing your investments
- Defining a share
- Buying for profit
- Discovering the five big pluses
- Reducing risk

If you've been hearing about the sharemarket for a long time, but you're only now taking the plunge, welcome aboard. There simply isn't a better place to invest money.

You're probably already familiar with shares and how they generate long-term wealth. In that case, you may want to skim through Chapter 1 and Chapter 2 quickly and then move on to Chapter 3 for an in-depth view of investment strategies. If that isn't the case, you're in the right spot to get started.

Investing Is All about Timing

Australians are among the world's most avid share investors, with 33 per cent of the adult population, or 5.9 million people, owning shares directly. This figure has fallen since 2004, when 55 per cent of Australians (or 8 million people) owned shares, but Australia is still equal-second in the world (with Hong Kong) when it comes to share-owning (the US is first with 52 per cent of Americans owning shares). The proportion of the Australian population owning international shares is also now 13 per cent, up from 10 per cent in 2012. Given that 19 per cent of Australian adults have owned shares in the past, chances are you've dipped your toes in the sharemarket pond before picking up this book.

Figure 1-1 shows share investing trends in Australia from 2000 to 2014.

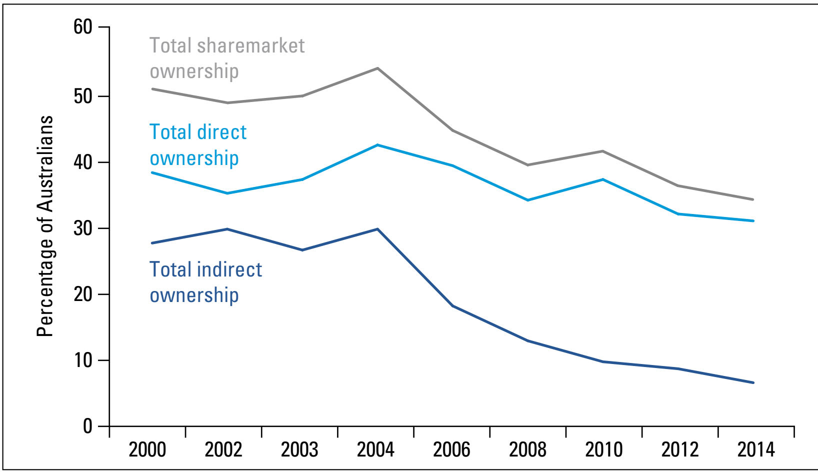


Figure 1-1: Share investing in Australia 2000–2014.

Source: 2014 Australian Share Ownership Study, Australian Securities Exchange

'Hang on,' you say, 'doesn't the sharemarket crash and correct regularly? What about the headlines that talk of billions of dollars of investors' savings being wiped off the value of the sharemarket in a day?' (See the sidebars 'What happened? The GFC at a glance', 'GFC economic recovery: Quick to lose, slow to come back' and 'Bouncing back from the GFC: Sharemarket recovery', later in this chapter.)

Occasionally, that happens. No one who goes into the sharemarket can afford to ignore the fact that, from time to time, share prices can suddenly move in an extreme fashion: Sometimes up, sometimes down. When share prices move down, they attract media headlines. However, what the headlines don't tell you is that on most other days, the sharemarket is quietly adding billions — or even just millions — of dollars in value to investors' savings.

REMEMBER

The unique qualities of shares or stocks (the terms mean the same thing in Australia) as financial assets make the sharemarket the best and most reliable long-term generator of personal wealth available to investors.

Since 1900, according to AMP Capital, Australian shares have earned a return of approximately 11.9 per cent a year, split fairly evenly between capital growth and dividend income, for a real (after-inflation) return of 7.8 per cent a year (which is almost double the return from bonds). Since 1950, according to research house Andex Charts, the All Ordinaries Accumulation Index (which assumes all dividends are reinvested) has delivered an average return of 12.0 per cent a year, for a real return of 6.9 per cent a year. In the 30 years to 30 June 2015, says Andex Charts, the same index has earned 10.8 per cent a year, for a real return of 7.3 per cent a year.

In 1985, according to the Australian Securities Exchange (ASX), the Australian stock market was valued at $76 billion, about one-third of Australia's Gross Domestic Product (*GDP:* The amount of goods and services produced in the Australian economy). In mid-2015, the stock market was valued at $1,700 billion, while GDP was about $2,000 billion. Although the nation's economic output has grown almost nine times since 1985, the value of the stock market has grown by more than 22 times.

Investing is about building wealth for yourself so that you can have the lifestyle you want, educate and give your children a good start in life, and ensure that you have a well-funded, carefree retirement.

When you invest in shares, you get a number of advantages, such as:

- The opportunity to buy a part of a company for a small outlay of cash.
- A share of the company's profits through the payment of dividends (a portion of company profits distributed to investors).
- The company's retained earnings working for you as well.
- The possibility of capital gains as the price rises over time.
- An easy way to buy and sell assets.

The sharemarket is unbeatable as a place for individuals to build long-term wealth. Shares can provide long-term capital growth as well as an income through dividends: More than half of the long-term return from the sharemarket comes from dividends.

The GFC dents Australians' love of the sharemarket

Australia is second only to the US as the world's leading share-owning democracy. But with the global financial crisis (GFC) souring many investors' experiences with shares, ownership had fallen to 36 per cent (33 per cent direct) by late 2014. According to the 2014 ASX Share Ownership Study, total share ownership (including retail managed funds) in Australia now stands at 36 per cent of the adult population, meaning that about 6.5 million people own shares. About 5.9 million Australians — 33 per cent of the adult population — own shares in their own right. According to the ASX's numbers, retail investors (as in households) own 13 per cent of the Australian sharemarket by value — about $220 billion worth of shares — and account for 14 per cent of trade by value, 51 per cent of trade by volume of shares and 12 per cent of the number of trades. In addition, in 2014, investment bank Credit Suisse estimated that self-managed super funds (SMSFs) own 16 per cent of the sharemarket.

The 2014 ASX Share Ownership Study also points out that 13 per cent of Australian share owners own shares listed on other exchanges (up from 7 per cent in 2002, but down from a peak of 19 per cent in 2006).

Australian share ownership rose dramatically between 1991 and 2004; in 1991, only 9.9 per cent of the adult population owned shares and total Australian share ownership (including retail managed funds) stood at only 21.8 per cent. Perhaps the memories of the 1987 sharemarket crash and the 1990–1991 recession were too vivid for Australians to trust the sharemarket back then. But two major factors sent the Australian shareholder population booming in the 1990s.

The first was a wave of privatisations, in which government-owned businesses were sold through the sharemarket. Prominent among these were Telstra, the Commonwealth Bank, Qantas, CSL and the former Totalisator Agency Boards of New South Wales, Victoria and Queensland.

The second was a succession of demutualisations, in which mutually owned insurers and cooperatives converted their structure to share-based companies and listed on the sharemarket. In this way, AMP, National Mutual (which then became AXA Asia–Pacific, which merged its Australian business with AMP in March 2011 and sold its Asian business to the French parent, AXA), the NRMA (now Insurance Australia Group) and even the ASX itself joined the sharemarket. Both AMP and Telstra brought more than one million first-time investors to the sharemarket.

By 1999, 54 per cent of Australian adults owned shares (41 per cent direct), but this fell to 50 per cent (37 per cent direct) by 2002, in the aftermath of the 2000 'tech crash'. The recovery from that slump saw share ownership rise again, to 55 per cent (44 per cent direct) by 2004, making Australia then the world leader.

Thirty-eight per cent of adult males were direct share owners in 2014, down from 40 per cent in 2008. But the proportion of women who were direct share owners fell from 30 per cent in 2008 to 27 per cent in 2014.

The likelihood of share ownership increases with age: The peak level of share ownership is the 75+ age group. People with higher incomes are also more likely to own shares; almost half those earning more than $100,000 a year own shares.

The sharemarket has an exaggerated reputation as a sort of Wild West for money and therefore it can be a daunting place for a new investor. The sharemarket is a huge and impersonal financial institution; yet paradoxically, it's also a market that's alive with every human emotion — greed and fear, hope and defeat, elation and despair. The sharemarket can be a trap for fools or a place to create enormous wealth. Those who work in the industry see daily the best and worst of human behaviour. And you thought the sharemarket was simply a market in which shares were bought and sold!

The sharemarket is precisely that: A place for buying and selling shares. Approximately $4.4 billion worth of shares change hands every trading day. Shares are revalued in price every minute, reacting to supply, demand, news and sentiment, or the way that investors collectively feel about the likely direction of the market. The sharemarket also works to mobilise your money and channel your hard-earned funds to the companies that put those funds at risk for the possibility of gain. That ever-present element of risk, which can't be neutralised, makes the sharemarket a dangerous place for the unwary. Although you take a risk with any kind of investment, being forearmed with sound knowledge of what you're getting into and forewarned about potential traps are absolutely essential for your survival in the market.

Finding Out What a Share Is

Companies divide their capital into millions (sometimes billions) of units known as shares. Each share is a unit of ownership in the company, in its assets and in its profits. Companies issue shares through the sharemarket to raise funds for their operating needs; investors buy those shares, expecting capital gains and dividends. If the company fails, a share is also an entitlement to a portion of whatever assets remain after all the company's liabilities are paid. The following is a partial list of share definitions.

A *share* is

- Technically a loan to a company, although the loan is never repaid. The loan is borrowed permanently — like the car keys, if you have teenagers.
- A financial asset that the shareholders of a company own, as opposed to the real assets of the company — its land, buildings and the machines and equipment that its workers use to produce goods and services. Tangible assets generate income; financial assets allocate that income. When you buy a share, what you're really buying is a share of a future flow of profits.
- A right to part ownership, proportional to the amount of shares owned. In law, the part of the assets of a company owned by shareholders is called equity (the shareholders' funds). Shares are sometimes called equities. They are also called securities because they signify ownership with certain rights.

Now you know what you're getting when you buy shares. You become a part-owner of the company. As a shareholder, you have the right to vote on the company's major decisions. Saying 'I'm a part-owner of Qantas' sounds so much more impressive than 'I'm a Qantas Frequent Flyer member'. Just remember not to insist on sitting in with the pilots; as a shareholder, your ownership of Qantas is a bit more arm's-length than that. That's what shares were invented to do: Separate the ownership of the company from those who manage and run it.

Sharing the profit, not the loss

When you're a shareholder in a company, you can sit back and watch as the company earns, hopefully, a profit on its activities. After paying the costs of doing business — raw materials, wages, interest on any loans and other items — the company distributes a portion of the profit to you and other shareholders; the rest is retained for reinvestment. This profit share is called a dividend, which is a specified amount paid every six months on each share issued by the company. Shareholders receive a dividend cheque for the total amount earned on their shareholding.

If the company makes a loss, shareholders are not required to make up the difference. All this means is they won't receive a dividend cheque that year, unless the company dips into its reserves to pay (for more on dividends, see the section 'Dividend income' later in this chapter). However, if a company has too many non-profitable years it can go under, taking both its original investment and its chances of capital growth with it.

Companies that offer shares to the public are traded on the sharemarket as limited companies, which means the liability of the shareholders is limited to their original investment. This original investment is all they can lose. Suits for damages come out of shareholders' equity, which may lower profits, but individual investors aren't liable. Again, shareholders won't be happy if the company continues to lose money this way.

Understanding the share in sharemarket

Shares aren't much good to you without a market in which to trade them. The sharemarket brings together everybody who owns shares — or would like to own shares — and lets them trade among themselves. At any time, anybody with money can buy some shares.

The sharemarket is a matchmaker for money and shares. If you want to buy some shares, you place a buying order on the market and wait for someone to sell you the amount you want. If you want to sell, you put your shares up for sale and wait for interested buyers to beat a path to your door.

The trouble with the matchmaker analogy is that some people really do fall in love with their shares. (I talk about this more in Chapter 7.) Just as in real love, their feelings can blind them to the imperfections of the loved one.

REMEMBER

Investors are wise to remember that their shares are assets that are meant to do a job: To make money for the investors and their families. Making money is what the right shares do, given time.

Because shares are revalued constantly, the total value of a portfolio of shares, which is a collection of shares in different companies, fluctuates from day to day. Some days the portfolio loses value. But over time, a good share portfolio shrugs off the volatility in prices and begins to create wealth for its owner. The more time you give the sharemarket to perform this task, the more wealth the sharemarket can create.

Buying Shares to Get a Return

Shares create wealth. As companies issue shares and prosper, their profits increase and so does the value of their shares. Because the price of a share is tied to a company's profitability, the value of the share is expected to rise when the company is successful. In other words, higher quality shares usually cost more.

Earning a profit

Successful companies have successful shares because investors want them. In the sharemarket, buyers of sought-after shares pay higher prices to tempt the people who own the shares to part with them. Increasing prices is the main way in which shares create wealth. The other way is by paying an income or dividend, although not all shares do this. A share can be a successful wealth creator without paying an income.

As a company earns a profit, some of the profit is paid to the company's owners in the form of dividends. The company also retains some of the profit. Assuming that the company's earnings grow, the principle of compound interest starts to apply (see Chapter 3 for more on how compound interest works). The retained earnings grow and the return on the invested capital grows as well. That's how companies grow in value.

Ideally, you buy a share because you believe that share is going to rise in price. If the share does rise in price, and you sell the share for more than you paid, you have made a capital gain. Of course, the opposite situation, a capital loss, can and does occur — if you've chosen badly, or had bad luck. These bad-luck shares, in the technical jargon of the sharemarket, are known as dogs. The simple trick to succeeding on the sharemarket is to make sure that you have more of the former experience than the latter!