

Investing in shares

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The sharemarket gives individuals the opportunity to buy and sell shares and gives companies the opportunity to raise funds via share issues to investors. A quality sharemarket investment can lead to both capital growth and income over time. Historically, shares have outperformed all other asset classes (cash, fixed interest and property).

What is a share?

When you purchase a share, you're effectively purchasing part-ownership in a company which may be listed on a stock exchange (either in Australia or one of the many stock exchanges around the world). This part-ownership entitles you to a share in the company's future profits which you receive in the form of share dividends. You also have the opportunity to benefit from the potential growth in share price as the company grows, which means your initial investment may grow as well.

Generally, a company will list on the stock exchange to raise money for planned activities, such as further expansion of their markets, an upgrade in technology or even the purchase of another company which complements their core business.

What types of shares are available?

You can purchase shares in a range of Australian and international companies. Company shares are available across many industries, from manufacturing and heavy industry to retail and exporting. In addition, you also have access to a range of property investments listed on the stock exchange, including office buildings, shopping centres, car parks and tourist resorts.

How do you invest in shares?

There are two main ways in which you can invest in shares:

1. **Directly.** You choose to buy and sell shares directly yourself – you have total control over your money and what you buy and sell. However, this means that you will need to research and manage those shares yourself (unless this is done for you by your financial adviser).
2. **Managed investment.** Your other option is to invest in a managed investment or a separately managed account, where your investment manager will research the shares and then buy and sell on your behalf (as well as for the other investors in that fund).

What are the benefits of share investing

There are a number of key benefits, including:

The ability to diversify risk

Share market investments involve an element of risk so diversifying your share portfolio is important. This means 'not putting all your eggs in the one basket.' In other words, spreading your investment risk across a variety of sectors (eg retail, manufacturing and industrial companies), as well as a range of fund managers (eg Perpetual, Colonial, IOOF). Investment performance is cyclical and although there will always be peaks and troughs, a diversified investment portfolio allows you to balance short-term troughs with cyclical peaks in performance ultimately smoothing your investment performance over time.

By investing in managed funds, it's easy to achieve a diversified investment portfolio with a relatively small amount of money.

Another way to spread your risk is to invest across a range of asset classes (eg property or cash).

Shares out-perform over the long term

Shares are a long-term investment (five to seven years) and this helps smooth out the short-term risk and fluctuations in investment performance.

Income stream and capital growth

Over time, share prices increase, so does the value of your initial investment. This is called capital growth and is important in helping your investment increase in value over time. In addition, regular income payments or dividends are paid by listed companies from profits. This gives you an ongoing income stream. Not only that, but as a company's share price is increasing, so can the dividends, because the dividends payable are calculated as a percentage of the value of the company.

Things to consider

The risks of investing in shares

There are two main risks associated with shares but fortunately both of these can be managed:

- The price of any particular share can fall unexpectedly and dramatically without much or any notice, however, the practice of diversification can lessen this risk. So if one does fail, the value of your overall portfolio should only be affected slightly. For more information please refer to the relevant fact sheet titled Investment Risk and Return
- The share market can experience fluctuating returns. While this can be stressful history tells us, the share market will generally improve its value over the medium to long term.

Why do share prices fluctuate?

It can be difficult to tell why in the short term share prices can fluctuate. Although, over the long term, the share prices of businesses listed on the stock exchange usually increase because of cautious financial management by the directors of the company. An investor should be aware that not all company profits are distributed to investors as dividends.

Part of the revenue will generally be kept by the company to reinvest into the business (for example to develop better technology, to buy other business, or to expand into new markets).

Through these activities, it is hoped that over time the value of the company grows, and this will have a positive effect on the share price and dividends.

Similarly, if a company is performing poorly or is subject to bad financial management or loses key staff, the residual panic in the markets can lead to the sale of company shares, resulting in a decrease in the share price.

What is dividend imputation?

Most companies pay tax on their profits before dividends are distributed to investors. In other words those dividends come to you 'tax paid'.

Your personal tax liability will be calculated after taking into account the tax that has already been paid by the company. The aim is to ensure that those profits are only taxed once. As a result, investors on low tax rates either pay no tax on the dividends or even qualify for a tax refund, while investors on the top marginal tax rate pay little tax on 'fully franked' dividends.

Ask your Bridges financial planner for more information.

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