Introduction to Investing as a South African

by Tumelo Koko

General Overview: Investing

Investing, in the general sense, is when you buy assets for the purpose of making more money. Assets include shares, listed property, commodities and bonds. There are a lot more assets available to someone who would like to invest, but these are the ones that are broadly used and easily understood. Making money from investments can work in one of two ways:

1. The value of the assets you have bought increases, or
2. Your assets entitle you to a payment

There are also cases whereby both happen at the same time.

Why Invest?

There are two major reasons for investing – namely: financial independence and generational wealth. You do not want to find yourself living from hand to mouth, just barely surviving from one salary to the next. This arises when we don't necessarily understand money in general and haven't decided what we want money to do for us. As much as time is money, money is also time. Money gives you the privilege of deciding what you want to do with your time, as opposed to your time being consumed by the pursuit of money. So, when one invests, one grows in the sense of developing good financial habits while creating wealth that transcend your individual lifetime. You learn to manage your money, attain good financial habits, and possibly find or create an alternative income stream.

Assets

To define what each of these assets are:

- Shares: when a company wants to raise capital, they issue shares. Shares are a partial ownership of the company. So, when you buy shares, you are buying ownership in the company in the literal sense.

- Listed Property: a listed property is when you buy shares in a company that primarily owns real estate. This usually entitles you to getting a percentage of the rent that the company receives. The value of your shares is also linked to the value of the properties that the company has. This diversifies your property investment because generally property companies own a number of different properties ranging from malls, storage warehouses and offices all the way to residential property.
- Commodities: these are physical goods or products that can be bought and sold freely. This includes things like gold, wheat, helium and so on. The value of commodities can be linked to the availability of those commodities.
- Bonds: buying a bond is in fact lending a company or the government (or other entities) money. You lend them this money for a certain period, during which you will be receiving interest payments. At the end of the term, you get your initial money back as well.
- Cash equivalent: this is when you leave your money in a savings account, money market account or under your mattress. Generally, this is the least risky option, but also gives you the least return. It also might devalue your money in the long run if the interest you earn (if you earn any) on your cash is less than inflation.

Necessary Understanding

Below are a few topics that if you understand well, you are well on your way to financial independence – or at least you'll escape traps that most people fall into.

- Asset: when one has money, the first thing to buy should be assets before any material objects. An asset can be loosely defined as an income generating (and sometimes capital preserving) possession. When you buy a car, you now have a mode of transport – and something to show off to your family. But, the car itself is not giving you cash in your bank account. So, unless you're buying a vehicle for business purposes, a car is not an asset. Shares, on the other hand, can yield an income in two different ways. Firstly, you could receive dividends from the company h whose shares you've bought. Secondly, the value of your shares could grow over time. Therefore, shares are assets.
- Inflation: To see inflation in action, here is a contextual example: I used to be able to buy brown bread for R7. These days, brown bread is as high as R15. However, this does not apply to bread only. So, with R100 back then, I could buy a whole lot more products than with R100 today. This is due to inflation. Inflation is basically our currency losing value over time. It is generally expressed as a percentage. For example, South African inflation is currently at about 4%, meaning that the rand is losing value a rate of 4% compounded annually. This happens due to a number of reasons, but our understanding of inflation is independent of its causes so they shall not be discussed. The existence of inflation has implications on your investments. If you save your money in a savings account that gives you less than 4% interest, it means you're losing money in the long run – even though it may seem like you're gaining. To put this in context, you save your R7 for 10 years (when the price of bread is R7), it grows to R13 in that time span, but bread is now R15 – this means you've lost R2 in the value of your money. Therefore, it is encouraged that you invest in equities.

- Compound Interest: this is when you earn interest on interest. If you earn 10% compound interest on R100, initially you'll get R10 as interest because that's 10% of R10. But then, you'll get R11 in interest next time, because that's 10% of R110 (R100+R10), and so on. As much as compound interest can work for you, it can also work against you. Generally, the interest on debt is compounded – one of the reasons why it is suggested that you get rid of your debt before you start investing.
- Indices: an index is a way to measure the performance of assets in the stock market. An index generally consists of a hypothetical portfolio of assets, and tracks their price movements. You cannot necessarily invest in an index directly, but you can invest in index tracking products like ETFs. The Top40 index in South Africa is an index that consists of the 40 largest companies in South Africa. You cannot buy the Top40 index, but you can buy a Satrix Top40 ETF or a Coreshares Top40 ETF. Investing in index tracking products is the easiest way to diversify your portfolio. It would also be cheaper to buy a Top40 ETF than to buy all 40 companies individually.
- Risk: this is the possibility of not making as much profit as you anticipated. This encompasses making losses as well. You could anticipate making a 10% profit on a particular investment, but make 5%, or even -5%. That possibility is risk. Different assets have different levels of risk.

  Securities that are regarded as lower risk securities include:
  - Cash in a bank or money market account
  - Government bonds
  - ETFs (even though similar to shares)

  Higher risk securities include:
  - Shares
  - Warrants
  - Derivatives
  - Corporate bonds

  Warrants, derivatives and corporate bonds will not be discussed for the sake of simplicity.

  To minimize risk, one should diversify their portfolio. To 'diversify' means to invest in a variety of different assets. Your portfolio becomes less vulnerable when diversified. Imagine a case whereby you invested your entire net worth in Steinhoff – you would be in financial ruin right now. But if Steinhoff was only 2% of your overall portfolio, the loss would have been offset by a gain in your other investments. Consider choosing your investments from a variety of industries, sectors, companies, regions and investment products. Sometimes buying highly correlated companies, for example buying only mining companies, is more risky because they tend to move together – if the mining industry is affected negatively your portfolio would suffer as well.

- What affects share price: The share price is the price at which a particular share can be bought or sold. The share price is determined by the supply and demand for a particular company's shares. Below is a list of factors that affect share price:
  - In the case where certain shares have more buyers than sellers the price of said shares will increase due to their high demand.

- When certain shares have more sellers than buyers the share price of said shares will decrease – there is more supply than demand.
- If a company is very profitable, a share in that company will become more valuable because more people think of the company as a good investment.
- Factors such as economic and political events also influence share prices.

Where do I begin?

When you build a house, where do you begin? The foundation.

Before you can even think of buying your first share, or even depositing money into your share account, or even opening an account to begin with, you need to have a solid financial foundation. A financial foundation is almost like a shield that protects your investments from you – because the best thing you can do for your investments is leave them to grow.

To build a financial foundation you need to do a number of things:

1. Know where your money goes – the best way to do so is by constructing a budget
2. Pay off all your debts, then
3. Build up an emergency fund
4. Max out your TFSA
5. Contribute to your RA (this is especially necessary if you do not plan to retire early)
6. Now you can start with your discretionary investments (your normal investing account)

This is as suggested by the JustOneLap.com team, and it makes complete sense.

Once you have the foundation, you need a Financial Services Provider or Stock Broker. What they do is allow you to buy and sell assets on the JSE (and other exchanges). These will be discussed further later.

Financial Services Providers

To buy or sell shares on the Johannesburg Stock Exchange you require a brokerage account with a financial services provider or stockbroker. However, buying and selling ETFs does not necessarily require such an account because you can contact the ETF provider directly to invest in these investment products. But, with this method, you can invest in ETFs and products provided by that specific ETF provider, so owning a brokerage account allows you to invest in all kinds of investment products, not only ETFs. When looking for an FSP or stockbroker, look for low fees, compare prices. For the beginner investor, it's also better to look for an understandable platform that does not have more functionality than you may need. More functionality tends to mean more fees, so be mindful. For the complete beginner, I would suggest using Easy Equities. Below is a list of financial services providers available in South Africa, and it is by no means an exhaustive list:

- Easy Equities (http://bit.ly/2RicK4V)
- Standard Bank Online Share Trading (https://securities.standardbank.co.za)
- Rand Swiss (https://www.randswiss.com)
- Absa Stockbrokers and Portfolio Management (http://www.absastockbrokers.co.za)
- Sanlam Private Wealth (https://sanlamprivatewealth.sanlam.com)
- PSG Wealth (https://www.psg.co.za/wealth)

Tips and Tricks

- Keep your cost of living low and invest the difference between your cost of living and your salary.
- Know the three, best wealth-building investments. People of all economic means make their money grow in ownership assets — stocks, real estate, and small business — where you share in the success and profitability of the asset.
- You want to invest for the long term, because ownership investments are more volatile. Don't invest money in such investments unless you plan to hold them for a minimum of five years, and preferably a decade or longer. This is the reason for having an emergency fund, you do not want to be a forced seller of your assets.
- For every cent you invest, know what the purpose is. Is it long term or short term? The sooner you'll need the money, the less volatile you should invest. For example, cash and bonds are the least volatile asset classes. Also, the younger you are, the more money you want to put in equities. This is because over really long time horizons, equities outperform all other asset classes.
- Put in the work. Do the research, read the financial statements, read the newspapers and email the CEO's. Be picky with your investing, be it in shares or any other asset classes, do not just act now and ask questions later. This will be detrimental to your finances.
- Take note of tax. Take advantage of your Tax Free Savings Account (which is incorrectly named) and your RA, know your tax bracket and its implications for your investments. Understand tax!
- Keep an eye on fees. Percentage fees are your worst enemies, you never want to pay 1% or more for ANYTHING! Every cent that goes to fees is a cent that could have compounded. Also, don't rationalize by saying to yourself that "you get what you pay for." Furthermore, invest an amount that makes sense in comparison to the amount of brokerage fees that you'll be paying.
- The scariest time you'll experience when investing is a stock market crash. When that happens, think of it as a sale. By then you should have decided which stocks or assets you believe in and

want to invest in: this is your time to buy aggressively. THIS IS A SALE! You don't sell when there's a sale going on, in fact, you buy at cheaper prices!

- Ignore the noise. Nobody can predict the future. So, don't go around selling off your well researched stock every time someone on TV says that they've found the hottest stock. Don't!
- Steer away from borrowing money to invest, especially if you are not sure whether the profit you will be making on the investment will be able to repay your interest on the loan and your loan over time.

Terminology

This entire list is not to be studied thoroughly. Neither is this list comprehensive. The financial world is full of jargon – this list serves as a reference for when you stumble upon words you don't necessarily understand.

- Actively managed investment: Relies on the expertise of a portfolio manager to choose the investment's holdings in an attempt to outperform a predetermined benchmark over the course of a full market cycle.
- Alternative investments: Generally refers to a diverse set of investment strategies that fall outside of the traditional purchase and sale of stocks and bonds. Some familiar examples of alternative investments include hedge funds, private equity and real estate. The appeal of alternatives lies in their potential to provide attractive risk-adjusted returns and additional diversification when compared to traditional asset classes.
- Asset allocation: How a portfolio is divided among different types of investments, such as stocks, bonds and cash.
- Annuity: A financial product sold by financial institutions pay out a stream of payments to the individual at a later point; primarily used as a means of providing guaranteed cash flow for an individual during their retirement years.
- Basis point: A unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed income security.
- Benchmark: A standard against which the performance of a security, mutual fund or investment manager can be measured.

- Capital Appreciation: Increase in the price of an investment; also, commonly referred to as the investment's growth.
- Capital gain/loss (realized/unrealized): The profit (loss) that results from a change in the price of an asset. A realized gain (loss) occurs when an investment security is sold as a price above (below) its cost. The amount that an asset's selling price exceeds its initial purchase price; a realized capital gain is an investment that has been sold at a profit, while an unrealized capital gain is an investment that has not been sold yet but would result in a profit if it was to be sold. A decrease in the value of an investment or asset from the initial purchase price; opposite of Capital Gain. A realized capital loss is an investment that has been sold at a loss, while an unrealized capital loss is an investment that has not been sold yet, but would result in a loss if it was to be sold.
- Capital preservation: An investment objective in which protecting the investor's initial investment from loss is the primary goal.
- Current income: Cash interest regularly received on fixed income investments and cash dividends regularly received on stocks.
- Dividend: Cash payment made by a company to stockholders.
- Dividend yield: Total amount of cash dividends received annually on a share of stock divided by the price of the stock.
- Dollar-weighted return: A method of calculating a portfolio return that looks at the total dollar values at the beginning and at the end of an investment, including any additions or withdrawals of funds, as well as the income and capital gains or losses.
- Economic sectors: Types of industries represented by the stocks held by the fund. The percentage of the fund's equity securities representing each economic sector is compared to the percentage of securities held in the fund's benchmark.
- Equities: Types of securities that represent ownership in a corporation and represent a claim on a proportionate share of the corporation's assets and profits, i.e. stocks.
- Expense ratio: Measures a fund's annual expenses as a percentage of the fund's net assets. Expenses include all management and administrative fees but exclude brokerage costs such as commissions.
- Fixed income investments: Debt securities, such as bonds and money market instruments, with specified interest and principal payment dates and amounts. Can also include preferred stock.
- Investment: A financial product or other asset or item of value acquired for the purpose and expectation of increasing its value through growth (increase in price) or income (dividends or interest) with favorable future returns.

- Investment objective: The goal of an investment strategy followed by an investor or investment manager. Investment objectives can be designed to generate long term growth, current income or a combination of both.
- Liquidity: The ease with which an investment may be bought or sold quickly without having a significant impact on the price of that investment. Also considering the fees charged and how soon you can access the money.
- Market: A public place where buyers and sellers conduct transactions, either directly or via intermediaries.
- Market capitalization: The market value of a company. It equals the current stock price of a company multiplied by the total number of outstanding shares.
- Market cycle: Generally regarded as a time period of 5 to 10 years.
- Passively managed investment: Designed to mimic the holdings of a benchmark in order to match the benchmark's returns before expenses, not exceed them.
- Performance: The change in value of an investment or portfolio over a specific period of time. The overall performance of an investment includes any income and realized and unrealized capital gains and/or losses.
- Portfolio: The combined securities held by an investor.
- Principal: The amount of money borrowed by a company in issuing a bond or other fixed income security. For many fixed income securities, it represents the amount that must be repaid by the borrower upon maturity.
- Real return: The return on an investment minus the effects of inflation.
- Return: The amount of money earned or lost from an investment in a particular period, usually expressed as a percentage of the total amount invested.
- Security: The paper right to a tradable asset that offers evidence of debt or equity issued by a corporation, government or organization.
- Simple Interest: Interest calculated on a principal sum, not compounded on earned interest.
- Time horizon: The amount of time until the allotted money is needed. This can typically be one, five, or even ten years.
- Total return: Indicates the short- and long-term investment returns earned by the fund, along with the returns of its benchmark and/or index. The amount of interest and gain or loss (selling price minus cost) earned on an investment over a given time period (generally one year).

- Volatility: The extent of fluctuation in share price, interest rates, etc.; the higher the volatility (price of stock moving up and down rapidly over short time periods), the less certain an investor is of return; therefore, volatility is one measure of risk.

References Used

- jse.co.za
- Investing for Dummies
- justonelap.com
- morganstanleyfa.com
- myccmi.com

Terms of Use

Afrikakesho.co.za/disclaimer.html