Mastering Investment: F1 – F7

What is an investment?

An investment is an asset acquired with the goal of generating income or capital appreciation. An investment always concerns the outlay of some resource today—time, effort, money, or purchase of an asset—in hopes of a greater payoff in the future than what was originally put in.

Why would people invest?

An investor is a party that makes an investment into one or more categories of assets with the objective of making a profit.

What is an investment strategy?

An investment strategy is a planned approach to how one intends to invest over a period of time. There are usually three phases of an investment:

- What to buy
- When to buy it
- When you dispose of it

You should sell your investment instruments because:

- They have achieved your target capital appreciation return
- They have lost value and are seen to be riskier
- You require access to liquid funds

The best long term investment strategy is to consistently save a predetermined percentage of your income, invest this across assets classes using direct ownership or fund structures, and to re-invest the income.

Risk

Investment Risk is the possibility of one or more of your assets losing their capital value or their potential for generating future income.

There is no way to avoid risk completely – one may reduce it through diversification or mitigate it through avoidance or insurance.

Diversification in investments is a way of spreading risk which can prevent an entire portfolio from losing its value

Interest rates

The interest rate is the cost of money and is expressed as a percentage rate that is calculated against the capital on an annual basis.

The factors built into the interest rate are:

- The cost of money (also known at the base rate)
- Inflation
- Liquidity
- Risk
- Time

What is an asset class?

An asset class is a grouping of investments that exhibit similar characteristics and behave similarly in the market. They are usually subject to the same regulations. To create your diversified portfolio, you should ideally invest across the four different asset classes which give you:

Cash	liquidity and emergency cash purposes
Bonds	Low capital growth + regular income
Equities	High capital growth potential + dividend income
Real Estate	High capital growth + low liquidity

Cash

Cash is used to finance your day to day operations, and acts as a form of savings that can be used to finance future investments.

However, cash gives a minimal return, and holding cash is risky (security and loss) and should be kept to a minimum. It is recommended that you should have 3 normal month's living expenses available in your bank account.

Bonds

A bond is essentially a debt instrument that pays interest which is usually fixed for the term of the bond. A bond is redeemed by the issuer upon maturity and is a short to medium term investment.

Bonds are subject to a high influence of market interest rates, since as interest rates change, they have an inverse effect on the price of fixed rate coupon bonds.

Equity

Equity (shareholding) in a company effectively makes the investor an owner of the company to the extent of the shares purchased. Ownership of ordinary shares gives the right to vote at the annual general meeting (1 share - one vote) and to receive dividends.

Equities are a long term investment, with potential for significant capital appreciation, but have a high level of risk since failure of the company could result in loss of the investment.

Real estate

Real estate is one of the most popular and valuable asset classes. Property is seen as a secure investment with potential for rental income. The purchase of real estate is high value and can be quite costly. Real estate is also very illiquid.

Funds

A fund, also knows as a mutual fund, allows a number of separate and unrelated investors to make investments by pooling their capital; investors can share costs and benefit from the advantages of investing larger amounts, including the possibility of achieving a broader diversification among of number of different assets and thus spreading risk.

Funds can generate income for investors (which are called distributor funds) or seek to maximise the capital value growth of their investments (accumulator funds).

- ## ETFs

An Exchange Traded Fund is an investment that allows investors to purchase units in the ETF, which would reflect an investment strategy through a diversified portfolio. ETFs usually track a specific index, a basket of commodities, bonds or any other asset classes or other investments that one could imagine. An ETF trades like a share on the stock exchange through a broker and experiences price changes throughout the day as they are bought and sold.

- ## Compound Interest

Interest is represented by a percentage value of the capital that is paid annually. Simple interest is the single payment of interest that is then withdrawn from the equation or the relationship governing the transaction is terminated. Compound interest is when interest is paid, annually, and this interest is capitalized such that subsequent years will pay interest on the capital as well as the interest received. This phenomenon, called compound interest, tends to increase the effect of the capital appreciation in an exponential manner over the long term.

Compound interest is useful because investors who reinvest their income will receive interest / dividends on the income that was reinvested, and therefore the value of the investment portfolio will increase exponentially in the long term.

By estimating the value of an investment in the present based on expected future earnings, one can apply the concept that money available at the present time is worth more than the same amount in the future due to its potential earning capacity. The underlying concept is that as long as it can earn interest, money is worth more the sooner it is received.

- ## Access to the market

One may purchase an investment when it is initially offered for sale to the market, called the primary market in accordance with the relevant Prospectus or Offering Document. This implies that the purchase is being made at a fixed offer price, directly from the issuer.

The alternative is to purchase an investment on the secondary market, through the services of a broker, at the prevalent market price. In this case, the purchase would be made from another investor.

The price of the security on the secondary market is determined by supply and demand and trades will be executed with the matching rules of the trading platform which provide for “best execution” prices

- ## Market index

A market index is a measurement of the value of a certain sector of the market, or the whole market, and is used by financial managers and investors to describe the market and to compare the return on specific investments. The change in value of an index is in many cases a better indication of the performance of that sector rather than the actual value of the index itself.