The ABC of investing

Novice investors need to prepare

Not even he knows. **George Soros, one of the world's most successful investors**

THE CURRENT ROLLER COASTER of share prices in both local and international markets will highlight the uncertainties of short-term share price movements, especially for novice investors. However, there's an old investment adage that notes: "It's not about timing the market, it's about time in the market."

The bottom line is that not even the world's most successful investors – such as Warren Buffett, Peter Lynch and George Soros – know exactly when the market will fall or rise. But they do know that market cycles are part of the process and, in the words of the classics, "you don't have a chance if you don't have a ticket". With that in mind, here are the first things you need to consider if you want to invest in shares on the JSE.

First, you need to clarify your own investment goals. Those could be long term – such as saving for retirement, for your children's education or even for a once-in-a-lifetime holiday – or short term. Those goals will depend on your age, current financial status and dreams.

Don't skip that step, as it will remind you of why you're sacrificing short-term consumption for your investments, as most will have to make a choice between investing for tomorrow or spending that money today. It's important to know whether those goals are short, medium or long term in order to decide what investments to make.

The second step is to clarify how much money you have to invest. One piece of prudent advice is not to invest borrowed money; another is to pay off all your short-term debt before you start investing. The reasons are simple: it's difficult to justify having money invested in the market at the same time as you're paying high interest rates.

With low inflation it's quite difficult to earn the same consistent return on your share portfolio as you're paying in interest to a bank. Your overall financial situation will be better if you first settle short-term debt before you start investing.

Traditionally, new investors needed a significant lump sum to create a share portfolio. However, that entry requirement has reduced – partly due to lower stockbroking commissions and fees and partly because of new share investment opportunities, such as exchange-traded funds and Standard Bank's Auto Share Invest.

Richard Seddon, head of Standard Bank Online Share Trading at the Standard, says that those who wish to build their own share portfolios can start with as little as R10 000 for a transaction and R50 000 for a portfolio in an online broking account.

The third step is to translate your investment goals into a blueprint for how you want to invest. For example, if you're investing to generate income then you need to consider buying shares with high dividend yields, also known as income shares. If you're young and saving for retirement you can afford a slightly more aggressive portfolio and so should look at growth shares. Middle-aged investors saving for retirement will want to consider blue chip shares to ensure capital growth with lower risk.

The fourth step is to decide when you'll sell. Bizarrely, that can be more difficult than deciding what to buy in the first place. So it helps to have an exit strategy mapped out ahead of time. The following reasons could spark a decision to sell your shares.

- You need the cash. Consider first if there aren't alternatives to accessing the money, especially if it's your nest egg.
- The market's fallen. Share prices usually recover after a downturn. Don't let short-term market volatility detract from your long-term goals.
- The shares no longer suit your investment goals. That could occur due to a change in your priorities or a strategic change of direction by the company.
- The share portfolio needs to be rebalanced. Consider if reducing one very large holding is your only alternative.

SA Warrants MD Simon Pateman Brown highlights that it's very important to know why you've bought a share. He warns investors not to become emotionally involved with their investments and to understand – and be disciplined about – an exit strategy.

To buy shares you'll have to place an order with a broker. In the South African market there are two different types of brokers who deal with individual clients: full service and discount brokers.

A full service broker will offer professional advice and company research by analysts. However, it does come at a higher cost.

Discount brokers – such as Online Share Trading – generally offer an execution service without advice. However, Standard Bank Online Share Trading does give its clients access to investment recommendations from Andisa Securities' rated research team.

Online Share Trading offers an Internet-based account. Investors can place buy/sell orders through its website, look up the I-Net consensus earnings forecasts and recommendations, set stop-losses and look up Stock Exchange News Service (Sens) announcements.

Online Share Trading also offers introductory investment seminars and introductory and advanced courses in technical analysis to help you get started investing in the market. Many of the courses are free to clients. ¤

| ONLINE TRADING |

Auto Share Invest

Allows clients to buy shares with minimum investments

ONE OF THE MAJOR OBSTACLES to investing directly in shares on the JSE is that it requires a relatively large capital sum upfront. The reason for that is simply economies of scale: the larger the size of a single trade, the lower the trading costs as a percentage of that trade.

However, ordinary investors who want to put a relatively small sum of money away each month can now invest directly – and cost-effectively – on the JSE. The first breakthrough was the launching of the Satrix exchange-traded funds (ETFs) in 2003. This year has seen a second breakthrough with the launch of Standard Bank's Auto Share Invest (ASI).

In a nutshell, ASI allows Standard Bank Internet banking clients to buy one or more 20 well-known South African shares directly. The shares are all in the Top 40 index and include companies such as Edgars, MTN, Telkom, Pick 'n Pay, SABMiller and Standard Bank.

Clients select a share or shares, with a minimum investment of R500/month in each share.

(Investors who want to buy Anglo Platinum will find that share requires a R600/month minimum investment.) A monthly recurring buy order online payment can then be set up, similar to online payments for telephone or utilities accounts.

Andisa Securities, a wholly owned subsidiary of Standard Bank, will execute all trades. ASI owners can check their portfolio online via Standard Bank Internet banking; the value will be updated daily to reflect the previous day's JSE closing prices.

AUTO SHARE INVEST

MONTHLY INVESTMENT (R)	FIXED COSTS	VARIABLE COSTS	TOTAL COSTS	COST (% OF AMOUNT INVESTED)	STANDARD BANK ONLINE SHARE TRADING BROKERAGE	BROKERAGE COST (% OF AMOUNT INVESTED)
500	20	1%	25	5,0%	115	23,0%
1 000	20	1%	30	3,0%	116	11,6%
2 000	20	1%	40	2,0%	119	5,9%
5 000	20	1%	70	1,4%	126	2,5%

Costs include brokerage, STRATE, Investor Protection Levy, VAT and UST

Source: Standard Bank

ASI charges a maximum of 5%/trade, which decreases as the investment amount increases.

As the table shows, a R500 investment will cost R25 (or 5%), while a R5 000 investment will cost R70 (1,4%). There's no monthly administration fee, though inactive accounts (with no trades) for 60 days or more will be charged R25/month.

That's cheaper than a number of other investment alternatives: brokers will charge a minimum brokerage charge of at least R200/transaction and a number of unit trusts charge 5% upfront, as well as an annual management fee of around 2%. Standard Bank Online Share Trading charges R115 to buy R500 worth of shares, apart from ASI.

ASI also allows investors to sell their shares by just selecting the date on which they'd like to transact. The proceeds of the share sale will be paid directly into their Standard Bank account five days after the transaction. Shares can only be sold once a week.

In addition to its share-trading platform, ASI also provides tools to assist investors in making their investment decisions. Those include all relevant Stock Exchange News Service (Sens) announcements and a fact sheet on each of the 20 companies. The fact sheet contains basic information on each counter, including a share's background and its price performance history. ¤

Stop losses

Allows investors to make selling decisions free of emotion

WHEN YOU INVEST IN SHARES there are five possible outcomes: a small gain, a large gain, breakeven, a small loss and a large loss. Richard Seddon, head of Online Share Trading at the Standard, warns investors to avoid those large losses that can undermine years of otherwise good investment returns. One way to avoid a major loss is to use a stop-loss.

Investopedia.com defines a stop-loss as: "An order placed with a broker to buy or sell once a stock reaches a certain price. A stop-loss is designed to limit an investor's loss on a security position."

Practically, that means an investor can set a stop-loss order at, say, 10% below the price at which he/she bought the share in order to limit the loss to 10%. If the share price falls below the stop-loss limit the broker will sell your shares at the current market price.

> Stop-losses aren't just to prevent losses, they can also be used to lock in profits – a tool that's sometimes called a "trailing stop".

The first advantage of a stop-loss is that you don't have to monitor your portfolio on a daily basis. However, the disadvantage is that a stop-loss could be triggered by short-term share fluctuations. Investopedia.com says

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that the key is to pick a stop-loss percentage that allows a share to fluctuate day-to-day while preventing as much downside risk (losses) as possible. Set your stop-loss at a level where it's unlikely to be activated by normal market movements, otherwise you could end up selling for no good reason – and paying extra commissions for the pleasure.

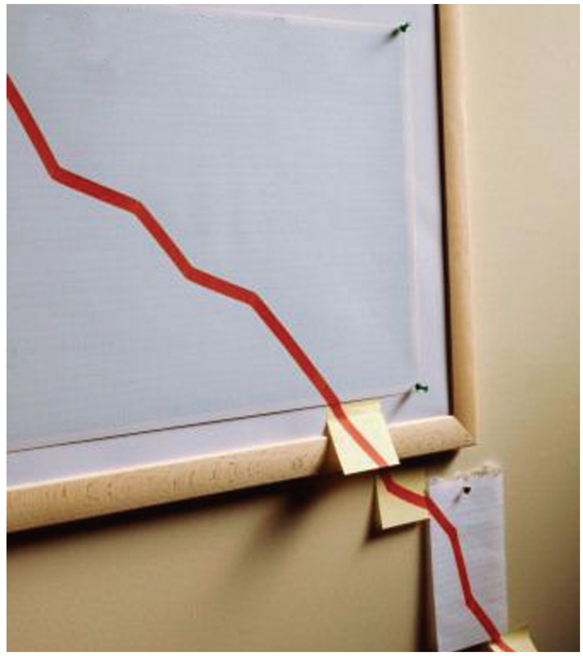
Second, stop-losses cost nothing to implement, though the broker will charge standard commissions on the sale if it's implemented.

Third, stop-losses allow investors to make a selling decision that's completely free of any emotion. Simon Pateman Brown, MD of SA Warrants, says that investors need to be disciplined concerning exiting loss-making investments and avoid becoming emotionally involved with their shares.

Investors should also remember that a stop-loss isn't an assurance of a selling price. Once the stop-loss is activated, the sell order is placed in the market. If a share's price is falling then the sale may be executed below the stop-loss price level.

Stop-losses aren't just to prevent losses, though that's their traditional use. They can also be used to lock in profits – a tool that's sometimes called a "trailing stop". In that case, the stop-loss order is set at a percentage level below the current market price rather than the price at which the share was bought. Investopedia.com says that using a trailing stop guarantees investors at least some of their unrealised gain on a rising share price.

Online Share Trading offers a free fixed and trailing stop-loss facility to all its clients. ¤

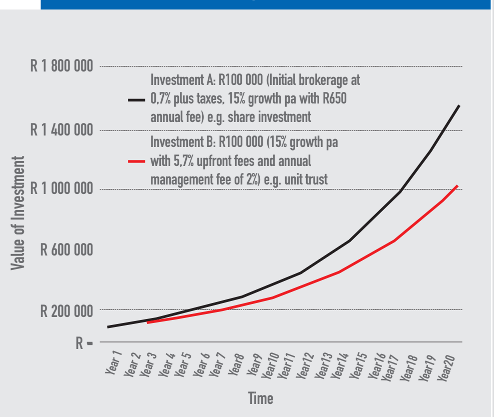


Trading costs

Compound interest can also work against you

COST IS A FOUR-LETTER word and, in investment terms, excessive costs can mean the difference between the success and failure of your investment strategy.

20 YEAR RETURNS ON A R100 000 INVESTMENT



The reason is that the miracle of compound interest (discussed in the first week of this series) also works the opposite way. Losses also compound with time. These losses can be from poor investments or the costs incurred in investing.

As the graph below shows, you'll be better off – from a cost perspective – investing directly in shares rather than letting someone else manage your money, as both unit trusts and managed portfolios incur management costs.

That's fair enough, as you're paying professionals for their time and skills.

However, you need to scrutinise the cost-benefit equation carefully. In this example you can clearly see how much of the value of the long-term investment you "donate" to third parties through upfront and annual fees.

Investing directly in shares has, historically, meant an x% difference between this portfolio and its closest rival.

If you believe that you don't have the skills to manage your own portfolio of individual shares consider buying an exchange-traded fund (ETF).

We'll discuss these in more detail next week but, in a nutshell, they let you buy an index of shares at relatively low cost.

Ultimately the value of your investments will be determined not only by the return those shares generate in future but also by how little it cost you to invest in the first place. ¤

QUIZ

EACH WEEK we'll publish three questions related to the week's content. At the end of the 12 weeks Online Share Trading will give R10 000 worth of Satrix shares in an online account to the reader who has correctly answered each week's questions.

To take part in the draw just answer the following questions and submit your answers either online to SBquizz@finweek.co.za or by fax to (011) 884-0851.

1. What tool can you use to avoid major losses?
2. What's the first thing you need to set when thinking about investing in shares?
3. Who do you place an order with to buy or sell shares?

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