



Introduction

The objective of these investment tutorial modules is to share some interesting findings and characteristics with other people involved in the financial and investment world.

The knowledge shared may be useful and beneficial to high net worth clients and others interested in different investment scenarios.

The modules will deal with stimulating topics such as an overview of different asset classes, some investment principles and advice on benefitting from investments on the very rewarding equity markets as well as many other useful tips and guidelines to wealth creation.

Smart investors and good financial consultants make it their business to gain some insight to all the asset classes available for investment and they tend to spread their investments or recommendations amongst some or all of these asset classes depending on the situation or investment scenario applicable at the time.

The following are the current eight primary asset classes available for investment:

(1) **Equity Markets** (Stock Brokers, Assurance Companies, Collective Funds, Hedge Funds, etc)

General ►

This is a capital and dividend driven asset class where the focus is mainly on growth and capital appreciation, but also provide excellent income stream opportunities as may be obtained from dividends and interest from preference shares and other corporate debt instruments.

Whilst there is a wide-spread perception that equity markets are very risky it is important to ask yourself why are more than 80% of all investments directly or indirectly in the equity markets.

Benefits ►

The returns on equity investments are unbeatable over the long-term and it is the most effective way to gain part ownership of any listed business of your choice.

A good selection of quality dividend stocks can eventually provide one with an excellent tax-free dividend income stream as well as capital appreciation.

If you have a reliable source to select companies from for investment or if you are an expert yourself in stock market trading the trading charges can be very low (less than 1%).

If you select to invest via endowment policies or retirement annuities it may be possible to add other benefits to the investment such as life cover, disability, etc.

Some of these life assurance and collective fund products also offer the facility for regular investments on a monthly basis which allows one to obtain price averaging and many of the assurance funded instruments may also contain excellent tax saving benefits for the investor.

Shortfall ►

If you do not know what you are doing and you are not using a sound stock nominator or good financial consultant you can land yourself in serious trouble on the equity markets.

If you select to invest in this asset class via endowment policies or collective funds you have to watch the costs, because it can be quite high.

(2) **Capital Markets** (Treasury Bills, Government Bonds, Retail Bonds, Gilts, etc)

General >

This is an income driven asset class with some focus on capital preservation and high levels of safety.

One moves funds to this asset class if things look bad for the equity markets and if prime interest rates show a strong downward trend.

You basically buy the coupon interest for the specific instrument.

For example, R1m may buy you R130,000 per annum interest (half paid each six months).

Benefits >

Basically you are investing in government backed securities and, therefore, your investment is very safe.

Depending on the coupon rates applicable for the specific instrument you use, the interest return can be quite attractive.

The coupon interest return on the R153, R154 and R155 is 13% per annum (paid half-yearly).

The coupon interest return on the R157 is 13.5%.

During difficult times where governments want to stimulate economies by lowering prime lending rates the quoted daily rate of the government stock issued will also tend to go down and this may be a great *capital appreciation* opportunity for investors.

If the daily quoted rate goes down the investor will have the benefit of some capital appreciation. This happens because it, now at a lower rate, will require more capital to buy the coupon rate interest you will earn.

Shortfall >

If the daily quoted rate goes up you may, however, experience capital erosion (as higher interest rate requires less capital to obtain the coupon interest).

(3) **Money Markets** (Interest earning instruments with banks and other institutions)

General >

These are the traditional interest earning platforms such as savings accounts and often used by retired people, because they feel safe with these investments.

Benefits >

Your initial capital is protected and it provides you with a constant income flow.

Shortfall >

The biggest shortfall of this instrument is the fact that your capital will almost certainly erode and be worth less and less as time passes.

Your income stream may fluctuate as interest rates change and this could make things difficult for someone who relies on this income to maintain their standard of living.

During 2009, on a popular financial radio program an example was given of an 80-year old pensioner who, when he retired, retained his entire pension in a guaranteed annual pension to be paid for life.

Today his pension only amounts to R400 per month, but if he had the opportunity to invest his pension funds in a living annuity tied to the JSE (equity market) his monthly pension today would have been at least R8,000 per month.

(4) Forex Markets (Foreign Exchange Facilities, Offshore Funds, etc)

General >

This is an asset class that gained a lot of favour during the past few years and basically relies on the differentials between currencies at certain times.

The basic idea is to buy other popular currencies when your own currency is very strong (you buy more of the other currency) and to sell it when that other currency again is much stronger than your own currency (you get more of your own currency from the other stronger currency).

Benefits >

This facility allows one to do offshore investments and to obtain an additional benefit if the currency changes are in your favour when you dispose of the investment.

There are people who make a living from Forex trading and it is big business.

Shortfall >

This is a tricky asset class and unless one is an expert in this field you may well be advised to stay clear of this asset class.

Recently a dangerous practice developed where so-called "experts" offer quick courses on mastering all the arts of trading in currencies.

If one considers that investor greats such as George Soros and Warren Buffet even get Forex trading wrong that should tell you something about the risks involved.

(5) Futures Markets (SA Futures Exchange, Single Stock Products, Options, etc)

General >

These are hedging instruments that gained immense popularity during recent years.

Futures, especially commodity futures such as coffee, beans, corn, maize, etc have been around for many years. In fact, futures trading in these commodities are some of the oldest trading formats in the world.

Recently new products such as Single Stock Instalments, Yield Enhanced Securities (YES Products), etc became very popular, especially amongst retail investors and even hedge fund managers.

Another older and better known options product such as warrants became very popular where one may actually benefit whether the markets move up or down.

Benefits >

These products actually make it possible to benefit from any market movement by buying "put" warrants if you expect the share price to drop and buying "call" warrants if you expect the share price to go up.

A "put" warrant will have the effect of gaining in value if the share price goes down.

Shortfall >

Utilising these instruments require extensive knowledge and insight and if applied incorrectly one may suffer considerable losses with these instruments.

(More information will be made available in a later module on Derivatives).

(6) Fixed Property (Estate Agents, Auctions, Syndicates, Property Developers, etc)

General >

This is a very popular investment asset class favoured by many novice investors. However, it is often incorrectly perceived as the best investment option available.

Benefits >

It is a physical asset that will over the long-term, at the very least, retain its original value.

It may also be applied to generate a regular income stream for the investor when it is used for letting to paying tenants.

Shortfall >

The total transaction costs are very high and can, in a worst scenario, amount to more than 15%.

It may also require high upkeep and maintenance expenses.

If let to tenants great difficulties may be encountered to collect rent and one would probably have to pay a collection resource or facility to manage the monthly rent collection.

Problems may also arise to evict undesired or non-paying tenants and one may have to incur considerable legal expenses to do so.

Severe losses may be encountered with property investments if something unforeseen should happen such as a squatter camp or a factory site popping up near your property, etc.

(7) Hedge Funds (Wide Variety of Hedge Funds)

General >

This is a fast growing capital driven investment platform facility that became so popular that it is now considered as a separate and fairly important asset class.

Currently there are more than 150 hedge fund managers in the RSA.

Benefits >

The ultimate objective of hedge funds is to implement counter strategies so that their clients may benefit from both positive as well as negative market movements.

These strategies may be:

- Selling short (selling stock you don't own)
- Using arbitrage (going long on commodity and short on equity)
- Trading options (futures based plays)
- Invest in anticipated little known events
- Invest in deeply discounted securities

Hedge funds may make it possible to eliminate the need for correctly timing entry or exits from stocks or markets.

Hedge funds could also provide additional diversification not otherwise available or limited in traditional stock market investing.

Shortfall

If not done correctly the hedge fund manager may end up covering all the bets to such an extent that it will be like playing all the numbers on a roulette table. This will almost, always lead to very modest returns.

These funds are not yet adequately regulated and transparency may still be a big obstacle or problem to some investors.

The great guru, Warren Buffet, once is rumoured to have said that he predicts that hedge funds may one day be known as the *financial instruments of massive destruction*.

Another problem with hedge funds, when they use futures strategies, is that if they really get it wrong they could lose so much money that they cannot meet withdrawals made by clients and then probably will go "belly up" as happened in several instances recently.

The latter probability, together with the lack of regulation, may make hedge fund investments very risky, especially to the conservative investor.

(8) Hard Assets (Art, Antiques, Vintage Cars, Coins, Gold Bullion, etc)

General >

These are appreciation driven instruments and are mainly focused on by specialist collectors and/or individuals trading in some of these instruments.

One should also be careful about gold and gold coins as an investment even though some dealers in these commodities claim very attractive returns.

Mostly, the returns claimed by such dealers seem to be over short or selected terms or it is as a result of limited editions, etc.

In fact, gold is not a very exciting investment and should only serve (if scenarios demand it) as a hedging instrument. Therefore, gold mining companies should also not be considered as investment opportunities, but rather seen as interim cyclic speculative opportunities.

Contrary to what many gold bulls want you to believe, gold in US\$ moved as follows:

- **Past 50 yrs** > from \$35 an ounce to \$1,000 ... this is **6.8%** p.a. average growth
- **Past 30 yrs** > from \$500 an ounce to \$1,000 ... this is **2.5%** p.a. average growth
- **Past 20 yrs** > from \$400 an ounce to \$1,000 ... this is **4.7%** p.a. average growth

It is true that the gold price in ZAR would have performed better, but that would be an unfair comparison as the gain is not only on gold, but also on Forex issues involved and such a benefit would have been obtained from any other US\$ dominated investment.

However, even if one added the considerable Forex benefit, the past 30-year return in Rands would have been R500 per ounce to R7,400 which gives you 9.4% p.a. average return over the 30-year term.

Benefits >

The primary benefit of gold and other precious metals is the fact that it can be very effectively used as a "safe haven" hedge in very volatile times. The reason being, many investors move to gold if they become jittery about economies or other stock holdings.

Probably the greatest and maybe the only real benefit of the other collectibles are the joy and pleasure experienced by the people owning these rare items.

Shortfall >

Only people with expert knowledge should get involved with most of the instruments in this asset class. Even hard assets such as exotic cars, where less expertise may be required, can also be tricky as research has shown that the real return on such investments after the cost of maintenance, service, insurance, etc are eventually seldom better than 3% per annum.

The biggest problem with these types of assets, of course, is the problem of loss as a result of fraud, theft and/or damage during ownership.

GENERAL COMMENTS

From the above, it becomes clear that equity based investments are probably by far the best method to create wealth over the medium to long-term.

We did not come across a single person, anywhere in the world, that became wealthy by investing money in the money markets, but we all know there are many people who became millionaires, even billionaires, from investments on the securities exchanges across the world.

It is said that the annual dividends earned by Bill Gates on his investments, mostly Microsoft, are more than the total worth of Donald Trump, the well known property tycoon.

The primary reason for many investors not participating directly in the stock markets is that they do not know how it works, they believe it is risky or they don't know which stocks they should buy or sell.

The weirdest thing is that many of them somehow believe that asset managers, stock brokers or stock pickers on TV programs will ensure that they buy the best stocks.

Research has shown that credible stock selection facilities such as Penny Hot Shares, The South African Investor (old Zurich Club), Prestige Bulletin, Valana Stock Market Investment Sense, etc will probably beat most other selection sources or equity funds hands down, most of the time *and at a much lower cost to the investor*.

During the past five years Penny, SA Investor and Prestige all showed a better than 20% annual return on their recommendation based portfolios.

During that same period the following popular collective funds performed as shown below:

Allan Gray Equity Fund	>	19.6%
Coris Capital	>	19.4%
Coronation Equity A	>	19.2%
Foord Equity Fund	>	18.2%
Investec Equity A	>	17.6%
Momentum Aggressive Equity	>	18.2%
Nedgroup Equity A	>	14.6%
Oasis Crescent Equity	>	16.9%
OM High Yld Opp Fund	>	12.7%
RMB Equity Fund	>	15.8%
Sanlam General Equity Fund A	>	17.4%
Sanlam Value	>	21.8%
Stanlib Value	>	20.7%
AVERAGE PER ANNUM	>	17.90%

It should be clear that a good credible stock selection facility will almost, without fail, do better than most collective funds.

The reasons for the above will be elaborated on in Module 8 when we will discuss Investments in Collective Funds.