Share investments

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Review set 7
The Share Market

Increasing numbers of Australians are investing in companies listed on the Australian Stock Exchange (ASX). In fact, around 60% of adult Australians own shares, either directly or indirectly (through managed funds or superannuation).

If you own shares in a company then you are really a part owner of the company. Large companies often sell shares to the public to obtain money to expand their business or to explore new opportunities.

Once these shares are issued, the owners of the shares can trade them at the Stock Exchange. The price of shares (their market value) is variable and is influenced by demand and supply forces.

Historical Note

The Stock Exchange of Adelaide was founded in 1887. One hundred years later, in 1987, all stock exchanges in Australia united to become The Australian Stock Exchange Limited (ASX). The ASX governs stockmarket trading in Australia and as such sets the Listing and Business rules.

The Listing Rules govern the procedures and behaviour of listed companies, whilst the Business Rules govern the procedures of the Stock Exchange and the behaviour of stockbrokers.

The ASX is funded through 3 sources of revenue:
- Listing fees
- Income from operations
- Contributions from stockbrokers

Role of the Stock Exchange

There are two types of markets that operate through the ASX:

The primary market is a market where a company raises its initial capital (money). Issuing a prospectus to potential investors via an underwriting broker allows investors to subscribe for shares. For example, a company may issue 20 million shares each with an issue price of 25 cents, to raise $5 million in a float. Investors can then remain as shareholders of the company or sell the shares to another investor on the secondary market.

Activity

UPCOMING FLOATS

1. Consider the following information from the ASX website:

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Industry Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moonshine Gas Limited</td>
<td>Not yet available</td>
</tr>
<tr>
<td>ph: 61 7 1234 5678</td>
<td></td>
</tr>
<tr>
<td>MSG</td>
<td></td>
</tr>
<tr>
<td>28 June 2008</td>
<td>Exploration for coal bed methane and conventional gas in Queensland</td>
</tr>
</tbody>
</table>
Issue Price 20 cents per ordinary share
Issue Type equity
Capital to be Raised $6,000,000
Expected offer close date 14 June 2008
Sponsoring Broker Territory Securities Pty Ltd

How many shares will Moonshine Gas issue to investors?

2 Visit the ASX website, www.asx.com.au and find similar information on other upcoming floats. View the prospectus of the company proposing to float and decide whether the investment would be sound. Follow the company until listing date. What did the shares trade for on the day they listed?

The secondary market is a market where issued shares can be traded via a stockbroker.

It operates as a continuous auction through the ASX's computer trading system known as SEATS (Stock Exchange Automated Trading System).

When a sell bid matches a buy bid, a trade is executed. The value of a share is determined by the auction process and may be influenced by factors like changes in overseas economies and markets, interest rates, inflation figures, industry factors and specific company news, etc.

THE STOCK BROKER

Any transactions carried out at the stock exchange must be done via a stockbroker. Stockbrokers are members of the ASX and are admitted if they can demonstrate professional experience, ability and financial stability. Once admitted as members, they are able to buy and sell shares for their clients for which they charge a fee called brokerage.

Their main functions are to:
- Act as an agent for share trading.
- Give investment advice to clients as to what to buy and sell, the best time to do so, and likely worth of particular shares.
- Act as an underwriter in new share issues. A broking house will publicise a new issue (float) of shares and guarantee full subscription. The broker will charge the issuing company a commission for this service and if all the shares are not purchased, the broking house buys the remainder.

LISTED COMPANIES

To become a publicly listed company, a business must be of sufficient size to enable a public market to be maintained in its securities.

Only public companies are allowed to be listed on the stock exchange and they must obey the Listing Rules set down by the ASX.

These include having:
- net tangible assets of at least $2 million or a minimum capital issue of $10 million
- a minimum of 500 shareholders
- aggregated profit over the previous 3 years of at least $1 million, with at least $400,000 profit in the last 12 months.
Half-yearly and full year financial results must be disclosed, along with any other sensitive information likely to affect the price of the shares.

A public company issues shares at a certain face value (par value) to the public in what is called a float.

This raises capital for use in expansion or restructuring of the business.

The company is then listed on the stock exchange and trading of its shares can commence.

Companies are usually run by a board of directors who decide on the business strategy and such things as payment of dividends, etc.

Advantages of public company listing
- Funds are raised to let the company expand its operations, lower debt or fund acquisitions.
- Investors are attracted to a company whose shares are easily traded on the secondary market.
- Greater public exposure can lift the corporate image of the company.
- Key staff can be retained by offering shares or options in the company as part of a salary package.

Disadvantages of public company listing
- Existing ownership is diluted as shares are offered to the public.
- Directors are accountable to shareholders.
- The ASX requires important information to be disclosed to the market.
- There are increased costs from listing fees, accounting and auditing fees, compliance costs, producing reports and maintaining the share register.

WHY INVEST IN THE SHARE MARKET?

Shares can offer sound investment opportunities with good long-term growth potential for investors. Wealth can be created in the form of capital gain from the buying and selling of shares and dividends received.

Studies show that the share market rises and falls in value, but falls are offset by growth in the long-term.

The following chart illustrates the 10-year performance of the All Ordinaries Index:
When prices are *trending upwards*, the share market is known as a "bull market" (a "bull" tosses prices upwards with its horns!). A bull market is clearly evident from 2003 to 2006. However, notice in 2002 that share prices *trended downwards*. This is known as a "bear market" (a "bear" market clawing prices down!).

Also notice that during bull markets or bear markets, smaller secondary trends still occur. A smaller upward trend is known as a "rally" and a smaller downward trend is known as a "sell off".

A sell off is often the result of profit taking after a rally, but other events such as specific company news (for example, management changes, profit warnings, dividend releases, etc.) and world events (for example, political changes, threats of war, etc.) can lead to rallies and sell offs.

The chart of the 10-year performance of the All Ordinaries shows why most financial advisors suggest that share investments should be for the long term, i.e., over 7-10 years. Long term investors will receive income in the form of regular dividends, and hopefully, capital growth via rising share prices. Many investors are attracted to the share market for a variety of reasons:

- **Risk and Return**: Although the share market can provide higher returns than other investment classes like cash and property, it comes with the burden of higher risk. However, risk conscious investors can control risks by investing in ‘blue chip’ shares. On the other hand, investors chasing higher returns often enjoy the thrill of investing in ‘speculative’ shares.

- **Liquidity**: This refers to how easily an investment can be converted to cash. Shares are generally a very liquid investment, depending on the volume of shares traded. A share portfolio or part-thereof can be sold in a matter of minutes, with the proceeds available in 2-3 business days. Compare this to the length of time it takes to sell an investment property!

- **Flexibility**: Many investors appreciate the flexibility of share investments. Poor performing companies can be sold quickly with minimal transaction costs and the proceeds invested into companies with better prospects.

- **Diversification**: Money can be spread over different industries providing a diversified investment portfolio.

Sound investment in shares can give returns that exceed other forms of investment, like residential property, and fixed interest over a ten-year period. The following graph shows investment returns for a number of asset classes for the 10 years to December 2004:
VALUE OF SHARES

Each share has two values - a face or par value, and a market or trading value.

**Face (par) value** is the value of the shares when first issued in a float.
**Market (trading) value** is the current price the shares are trading for on the ASX.

TYPES OF SHARES

Different types of shares exist.

**Ordinary Shares**

These are the most common type of share issued. Their main features are:

- Shareholders are part owners of the company.
- You can vote at the Annual General Meeting (AGM) of the company.
- You are entitled to receive dividends paid from the company’s profits (quoted as cents per share).
- The par value of the shares is returned if the company is wound up. However, this is only if funds are available, as ordinary shares rank last in priority.

**Preference Shares**

Some companies also issue preference shares. Their main features are:

- A fixed dividend rate of the par value is paid, for example, 8% of $0.50.
- Preference dividends are paid first, i.e., before any ordinary dividend is declared.
- Shareholders usually have restricted voting rights, but are still classified as part owners of the company.
- The par value of the shares is returned if the company is wound up, but preference shares rank before ordinary shares.

TYPES OF STOCKS

Different types of stocks also exist.

Economic expansion often leads to more demand for commodities like iron ore, aluminium, gold, oil and gas. Major mining companies like BHP and Rio Tinto have recently benefited from higher commodity prices caused by a surge in demand from China and hence undersupply for basic commodities. Companies affected by the economic cycle in this way are called **cyclical stocks**.

Companies that are shielded from cyclical factors are known as **defensive stocks**. The big banks, health care stocks, Telstra, food retailers like Woolworths, and gaming stocks like Tabcorp, are examples of defensive stocks.

Defensive stocks are often popular during times of economic recession, whilst during times of economic growth investors will turn to cyclical stocks or even **growth stocks** (companies with good prospects for future expansion).