BECOMING AN INVESTOR

An introduction to investing and investments brought to you by Martin Hawes and the Summer KiwiSaver scheme.

At some point in life many people give some thought to the idea of investing. For some it will go no further than that, just a thought. Others can see the benefits, and take a closer look. And some become investors.

So why become an investor? There's no single answer. Different people have different reasons. For some it will be to help fund their retirement, for others it is to help their children though university. Some may have come into some money through inheritance or the sale of a business and others have saved carefully, putting aside a little every pay day.

A popular definition of investing is using your money to make money.

The kind of investment, or investments, you choose to make comes down to you, your situation and what you would like your investment to do for you.

Investment is really all about you, and helping you get what you want from life.

The Investment Advisor

If you're new to investing, or even if you have invested frequently over the years, deciding to talk to an experienced and qualified investment advisor may be one of your most important decisions.

The investment advisor is there to help understand you - who you are and what you are trying to achieve with your money.

They will want to talk to you about your attitude to risk, how long you want to invest your money for and whether you'll need to draw on it for any expenses or lifestyle requirements. They will listen to your views on ethical investing to understand any preferences you have, and together they will help create an investment plan for you to help achieve your investment objectives.

That's why it's worth seeking out the best advisor for you. Ask around. Talk to friends and colleagues who may have used an investment advisor they're happy to recommend. Ask your lawyer or accountant and browse the internet to learn more. Speak to some investment advisors; it's going to be an important relationship so it's essential that the investment advisor you choose is someone you are comfortable with and can easily talk to.

A vital document

Upfront, an investment advisor must, by law, give you their disclosure statement. This essential document covers six important points:

- Their experience and qualifications
- Whether they have any criminal convictions
- The types of investments they advise on
- Interests they have that could influence their advice
- Relationships that could influence their advice
- Their fees

And, if they are a share-broker, they will need to let you know their procedures for dealing with your money.

Your first meeting

So, you've chosen your investment advisor - now it's time to tell them what you want as an investor. Set aside a couple of hours, because they need to find out about you, your goals, your requirements, your comfort with risk and more.

Here are the main topics to discuss:

Your investment goals

It's important to have a vision of what you want your investment to achieve for you. Perhaps you're saving for retirement, or it might be to help your children into their first home. Maybe you want to go on a long overseas holiday in the future. What do you want your investment to do for you?

Your income

Understanding your income needs is key to your investment strategy, so you'll want to talk about your current and future requirements. Think about what your regular outgoings are, do you have plans around replacing a car or overseas travel that will reduce your capital and therefore the income that is generated?

Your time-frame

Your investment advisor will need to understand when you would like to withdraw some or all of your money from your investment. Perhaps you want a regular income from a particular date onwards, or maybe you would like a lump sum payment.

Your comfort with risk

The truth is that very few investments are guaranteed, and risk is simply part of investing. Think about how you would feel if you were to lose a proportion of your invested funds. Do you need some money that is available instantly?

Your situation

Your investment may be for you as an individual, or you may have a family trust and would like your investment made on behalf of the trust. You might like to take a hands-on approach to managing your investment, or choose to give the reins to someone else.

And more...

You want your investment advisor to be your long-term partner, helping you make important investment decisions. You'll have many more conversations with them over the years, but this first meeting is your opportunity to get off to the right start.

Types of investments

The question is where should you invest? Naturally, it all comes down to what you want to achieve. While there is a world of hybrid and derivative investments, and also the consideration to invest in New Zealand or overseas, in simple terms there are four asset classes. These are cash, bonds, property and shares. Through managed investment schemes, such as the Summer KiwiSaver scheme you can invest in a combination of all four asset classes.

Cash

Bank savings accounts

The most simple short term investment, and probably one that most people are familiar with is a bank savings account. They're a good choice for short-term savings goals like a holiday or as a place to keep money for an emergency.

If you need to get at your money whenever you want, they score there as well. As a result, returns tend to be low compared with other types of investment.

Bank fixed term deposits

This is another option for short or medium term investment. Here your money is locked away for a set time, usually three, six or twelve months, and sometimes up to five years. In return, you'll generally earn a rate of return higher than an ordinary bank savings account.

You might be able to 'break' your fixed term investment should you need it earlier, but this will likely incur a penalty.

Bonds

Think of a bond as an I.O.U. One that's issued to you by the Government or a company. We call them the Issuer. You make a gain through interest paid to you in the future. You give the Issuer money for a set period; they promise that at the end of that time they will repay you the money plus interest.

This kind of investment is sometimes called 'fixed interest' or 'bank bills' and 'Government stock'. Usually, there's a minimum amount you can invest and you may not be able to get your money out if you need it - although many bonds are now traded on the stock exchange which can help.

The value of a bond may go up and down in relation to changes in the level of interest rates, in general, or for reasons related to the company that issued the bond.

Property

A popular way to invest is to purchase an investment property.

The downside is that creating and managing a property portfolio means you'll need to know your stuff: location and type of property, city or rural, residential, retail, warehouse, farm or motel, financing and taxation arrangements, maintenance requirements, lease terms, tenants and record keeping.

You or a property manager will have to deal with it all. Owning an investment property is a bit like operating a small business – in other words, hard work.

On the other hand...

You can be in a fund that invests in property assets, not just a single property. This could be by way of ownership of rented buildings, or an investment in shares of public companies which specialise in property ownership, called listed property companies.

It means you get the many advantages of property ownership without having to find the property and do the hands-on management yourself. This approach also brings the benefits of diversification, which you'll read more about shortly.

Shares

Think of shares as portions of ownership in a company.

As a shareholder you own part of the company. And that means you get the right to share in the future income and value of that company.

Shares are longer-term investment, because over the long term, the value of listed companies has tended to increase at a higher rate than inflation. If the company does well, the value of your shares rise, and if the company doesn't do so well, the value falls. There are two ways that you, as a shareholder, can share in the company's fortunes:

- By receiving dividends paid out of the profits made by the company
- By making capital gains/losses made because you are able to sell your shares for more or less than you paid.

Any loss or gain in value is 'realised' when you sell the shares. If you hold onto them the loss or gain is 'unrealised' but will be acknowledged in any revaluation reports, which will reflect the current market value of the shares.

The value of shares can vary from one day to the next. On any day shares in any individual public-listed company may go up or down in value, depending on how investors view the prospects of each company. Checking how your shares are doing each day doesn't really give you the big picture, because it's usually about long-term performance.

The managed fund

In a managed fund, your money is pooled with other investors, and a professional fund manager invests it in a variety of investments. Some managed funds target all-out growth and invest in higher risk shares— they could rise or just as easily drop in value. Others, like the Summer KiwiSaver scheme, are designed to deliver positive long-term returns from a range of deposits, bonds and shares.

It's good to know that some managed funds are PIEs (Portfolio Investment Entities). These may have some important tax advantages. Tax paid by a PIE on your behalf means you will not need to fill in a tax return for the income you receive on these investments.

A few alternatives

Outside of the four main asset classes discussed, there is a world of investment options. They include gold, hedge funds, commodities, foreign currency speculation (as opposed to hedging) and others. Generally speaking though, these alternatives are for experienced investors. They require a lot of commitment, and thorough knowledge. They usually have a high minimum initial investment, and a higher level of risk.

A direct or indirect approach

Are you into DIY, or do you prefer to get someone else to do the work? When it comes to investing there are two ways you can go. You can go it alone or get an investment advisor to help you make the right investment decisions.

Direct Investment

This is the do-it-yourself approach. Going to a sharebroker and buying some shares is an example of direct investment. By investing directly in term deposits, bonds, shares and property you can save costs, and get a sense of satisfaction that comes with doing it yourself.

Indirect investment

Indirect investment means that you appoint someone, a fund manager, to make the investment decisions for you. For instance, by placing your money in a managed investment scheme, like the Summer KiwiSaver scheme, experienced fund managers will look after your investment and make the decisions for you.

Risk - a fact of investment

All investments carry a level of risk. Generally speaking, the lower the risk, the lower the expected return. The higher risk, the higher the return. Wise investors only take on higher investment risk if they feel they will be adequately rewarded, through higher returns. In this way risk and return are related.

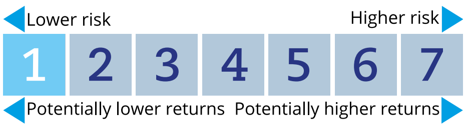
Types of risk

An investment is said to be "risky" if there is a reasonable chance that its value will change significantly in the future.

For example, an investment in shares is riskier than an investment in a bank term deposit: the value of shares may fall below the price you paid for them while the value of bank deposits usually doesn't. The simple rule is that high risk investments should only be taken on with long-term intentions.

Risk indicators

One way of depicting the level of risk for investment is through a "risk indicator". This is common for managed funds.



The risk indicator is rated from 1 (low) to 7 (high). The rating reflects how much the value of the fund's assets goes up and down (volatility). A higher risk generally means higher potential returns over time, but more ups and down along the way.

Note that even the lowest category does not mean a risk-free investment. There may also be other risks specific to the investment that are not captured by the rating.

To help you clarify your own attitude to risk, you can seek financial advice or work out your risk profile at *www.sorted.org.nz/tools/investor-kickstarter*.

Risk indicators are usually worked out based on how volatile the returns have been in the past, and are not a guarantee of future performance.

Three ways to manage risk

1. Diversification

If risk is all part of the game, then you cannot avoid it, but you can manage it. There are several ways to do that. The most well-known is diversification.

If you ask a wise investor how they like their eggs, they would say 'not in the same basket'.

Diversification means allocating your capital across several, carefully chosen, asset classes. So, if one or more of your investments is delivering lower returns, others should be performing to offset those lower returns. When one is 'down' another is 'up' which is why a well-diversified portfolio provides more stable growth.

2. Research

Markets are in a state of constant change and these changes may impact on the value of your investments. Market movements can make investors ask questions such as "what does the latest interest rate hike mean for my investments?" or "Commodity prices are rising, should I be reviewing my asset allocation?"

It's also easy to be swayed by sensational news headlines. A headline about the economy may look dramatic because that's what sells news, but what's really happening?

The real answer lies in research. Good research is important because when you know what's really going on you can plan an effective course of action.

Research analysts

These specialists conduct in-depth and fundamental research on the securities of companies they are considering investing in. They also observe international markets and economies and review advice from others observing the markets. Research helps build a picture of what's really happening, to help you effectively manage risk.

3. Ratings

Credit rating

A credit rating is an independent assessment of a borrower and tells you about the risk it can't meet its financial obligations.

For instance, it may guide investors on the borrower's ability to pay back the money it owes to investors, on time and in full? It's an indication as to the state of the business and a useful relative indication of the risk of investing in one business over another.

Investment grade ratings

You'll sometimes hear the term 'investment grade' to describe an investment with a certain credit rating. It simply means that the investment has a rating of BBB (Standard & Poor's and Fitch) or Baa (Moody's), or better.

It doesn't necessarily mean that you should automatically invest though. A strong rating isn't a guarantee that an institution is more likely to do well than a weakly rated one. Even a triple A-rated organisation could default in the future.

As with everything, it's up to individual investors to decide what level of credit risk to take on and what level of return to demand for that risk.

Creating your portfolio

Building a well-diversified portfolio

The goal is to combine assets that have different risk and return profiles. When one or more of your investments is delivering lower returns, others should be performing to offset those lower returns. When one is 'down' another is 'up' which is why a well-diversified portfolio provides more stable growth.

Matching your risk profile to your portfolio

The idea is to have a portfolio mix or asset allocation that matches your risk profile. The riskiness of each asset class may be determined by looking at how it has performed in the past. Rates of return change over time, but the broad volatility of asset classes do not change much.

Stock security selection

Within each asset class in your portfolio, it's good to have a range of investments, again to spread the risk. For example, you could have a mix of local and overseas shares or a collection of shares from different industry sectors.

Watching what the professionals are doing

An easy way of seeing whether you are on the right track with your own asset allocation is to compare it with the way professional fund managers allocate the assets they manage for 'the average investor.'

Monitoring and managing your portfolio

Your personal circumstances will change over time

Part of the ongoing management exercise is to ensure any changed circumstances are reflected in your portfolio.

- Income needs – perhaps you have had a salary increase, or changed jobs. Perhaps you'd like to invest more, or less.
- Risk tolerance – as people get older, tolerance for risk changes. It's human nature to become more conservative as we age.
- Personal or financial circumstances – From a relationship change to a windfall, it's time to take a look at how it will impact on your portfolio.
- Investment time-frame – as you get closer to achieving an investment goal, it's time to make a few adjustments.

The fine art of rebalancing

If one asset class in your portfolio performs well and another not so well, over a certain time period, the better performing asset will make up a larger proportion of your total portfolio.

This means your portfolio has changed, which means it's time to rebalance to get it back in line with your investment strategy. So you might choose to sell some of the outperforming asset and buy some underperforming assets at lower prices.

You should also look at the investments within each asset class. Over time, these change, - for example, companies may lose market share or new technologies or discoveries may propel a company forward. Again, this can change your portfolio.

The Summer KiwiSaver scheme encourages you to get involved in your investing

Why is it good to be involved? Because it's your money and it's different to everyone else's money – because what you plan to do with your money won't be the same as what I plan to do with my money. And when it's your money, you want to be involved. The great thing about this is that you learn by doing. When you're in the Summer KiwiSaver scheme you can be an active investor.

How do we help you do that? Experienced Authorised Financial Adviser, author of over twenty books and financial commentator Martin Hawes has joined us.

As Chair of the Summer Investment Committee, he and our investment managers will provide information and guidance to help you make sense of what is happening in the markets and what you might need to be thinking about. You won't find EBITDA and PE ratios here, rather plain English explanations that will help you make your decisions.

Mind you, you can be confident that we do have all the important analysis and market insights because the Summer KiwiSaver scheme is part of the Forsyth Barr group. A New Zealand owned company, with an 80 year history of helping New Zealanders get to where they want to be.

The Summer KiwiSaver Scheme is managed by Forsyth Barr Investment Management Ltd. You can obtain the Scheme's product disclosure statement and further information about the Scheme at *www.summer.co.nz*, from one of our offices, or by calling us on 0800 11 55 66. Forsyth Barr Investment Management Ltd is a licenced manager of registered schemes and part of the Forsyth Barr group of companies. Disclosure statements are available from Martin Hawes and your Forsyth Barr Authorised Financial Adviser, on request and free of charge.

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