



## **Elective Module 8: Nature of Investment Learner Resource Guide**

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### **Learning Outcomes**

Nature of the product/investment vehicle

Advantages and disadvantages of the product/ investment vehicle

Potential clients

Preferred sales method and sales channels

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# Chapter 1

## Nature and Objectives of Investment

### Introduction

The word “investment” can be defined in many ways according to different theories and principles. It is a term that can be used in a number of contexts. However, the different meanings of “investment” are more alike than dissimilar. Generally, investment is the application of money for earning more money. Investment also means savings or savings made through delayed consumption. According to economics, investment is the utilization of resources in order to increase income or production output in the future.

An amount deposited into a bank or machinery that is purchased in anticipation of earning income in the long run is both examples of investments. Although there is a general broad definition to the term investment, it carries slightly different meanings to different industrial sectors.

According to economists, investment refers to any physical or tangible asset, for example, a building or machinery and equipment. On the other hand, finance professionals define an investment as money utilized for buying financial assets, for example stocks, bonds, bullion, real properties, and precious items.

According to finance, the practice of investment refers to the buying of a financial product or any valued item with anticipation that positive returns will be received in the future. The most important feature of financial investments is that they carry high market liquidity. The method used for evaluating the value of a financial investment is known as valuation. According to business theories, investment is that activity in which a manufacturer buys a physical asset, for example, stock or production equipment, in expectation that this will help the business to prosper in the long run.

### Types of Investment in Security Analysis and Portfolio Management

#### Types of investments

Investments may be classified as financial investments or economic investments. In Finance investment is putting money into something with the expectation of gain that upon thorough analysis has a high degree of security for the principal amount, as well as security of return, within an expected period of time. In contrast putting money into something with an expectation of gain without thorough analysis, without security of principal, and without security of return is speculation or gambling. Investment is related to saving or deferring consumption. Investment is involved in many areas of the economy, such as business management and finance whether for households, firms, or governments.

Economic investments are undertaken with an expectation of increasing the current economy’s capital stock that consists of goods and services. Capital stock is used in the production of other goods and services desired by the society. Investment in this sense

implies the expectation of formation of new and productive capital in the form of new constructions, plant and machinery, inventories, and so on. Such investments generate physical assets and also industrial activity. These activities are undertaken by corporate entities that participate in the capital market.

Financial investments and economic investments are, however, related and dependent. The money invested in financial investments is ultimately converted into physical assets. Thus, all investments result in the acquisition of some asset, either financial or physical. In this sense, markets are also closely related to each other. Hence, the perfect financial market should reflect the progress pattern of the real market since, in reality, financial markets exist only as a support to the real market.

## **Nature and Objectives of Investment Management**

### **1.1 Nature of investment**

The features of economic and financial investments can be summarized as return, risk, safety, and liquidity.

#### **Return**

All investments are characterized by the expectation of a return. In fact, investments are made with the primary objective of deriving a return.

The return may be received in the form of yield plus capital appreciation.

The difference between the sale price and the purchase price is capital appreciation.

The dividend or interest received from the investment is the yield.

The return from an investment depends upon the nature of the investment, the maturity period and a host of other factors.

**Return = Capital Gain + Yield (interest, dividend etc.)**

#### **2. Risk**

Risk refers to the loss of principal amount of an investment. It is one of the major characteristics of an investment.

The risk depends on the following factors:

The investment maturity period is longer; in this case, investor will take larger risk.

Government or Semi Government bodies are issuing securities which have less risk.

In the case of the debt instrument or fixed deposit, the risk of above investment is less due to their secured and fixed interest payable on them. For instance debentures.

In the case of ownership instrument like equity or preference shares, the risk is more due to their unsecured nature and variability of their return and ownership character.

The risk of degree of variability of returns is more in the case of ownership capital compare to debt capital.

The tax provisions would influence the return of risk.

### 3. Safety:

Safety refers to the protection of investor principal amount and expected rate of return.

Safety is also one of the essential and crucial elements of investment. Investor prefers safety about his capital. Capital is the certainty of return without loss of money or it will take time to retain it. If investor prefers less risk securities, he chooses Government bonds. In the case, investor prefers high rate of return investor will choose private Securities and Safety of these securities is low.

### 4. Liquidity:

Liquidity refers to an investment ready to convert into cash position. In other words, it is available immediately in cash form. Liquidity means that investment is easily realizable, saleable or marketable. When the liquidity is high, then the return may be low. For example, UTI units. An investor generally prefers liquidity for his investments, safety of funds through a minimum risk and maximization of return from an investment.

#### Article 1

##### My investment profile - Investor types & investing smart

To be successful with investing, it's important to figure out what type of investor you are, which is sometimes called our 'investor profile'.

##### The four elements

Many people typically have different investment goals. Imagine saving for an overseas holiday, and saving for retirement at the same time. So depending on what we need to achieve, we can have separate investor profiles to match each goal. Here are four key things to consider when investing: duration, returns, liquidity and risk.

| When considering... | Ask...   |
|---------------------|--|
| Duration            | How long do I want to invest for?                |
| Returns             | Do I want income and/or growth?                  |
| Liquidity           | Do I need to get to my money easily?             |
| Risk                | What balance of risk and reward is right for me? |

##### Duration

Duration means how long we want to invest for.

Short term – 1 to 3 years

Medium term – 4 to 9 years

Long term – over 10 years

Saving for an overseas trip in a year's time is a short-term investment. So it's important to be able to get it when we need it.

Saving for a deposit to buy a house in five years' time is an example of a medium-term investment.

Saving for retirement is usually a long-term investment.

Over a longer period of time we'll be more interested in capital growth. This is when the value of our investment (our capital) grows. If we invested \$100,000 in shares last year that are worth \$110,000 this year, our capital growth is \$10,000, or 10%.

It's common to have different investments of different durations.

### **Returns — income or growth?**

To work out the most suitable type of returns (the money we earn from investments), we need to decide if income or growth is a bigger priority. We could ask:

Do I want to use the money my investment earns as income to live off during the duration of the investment?

Do I want to reinvest it with the original amount, and grow my lump sum as much as possible?

If short-term income from investment is important, it's probably best to put the money where it will earn a guaranteed return. For example, a bank deposit paying a fixed amount of interest for a set period.

If we want to grow a nest egg as much as possible and don't need the income in the short term, we can consider investments that don't guarantee the return from year to year, such as shares.

### **Liquidity**

Liquidity means how quickly we can convert our investment into cash before the end of the investment period.

A high-liquidity investment means we can get at our investment any time. A bank savings account is an example.

In a low-liquidity investment, it may take time to find a buyer and complete the sales process. Property is usually a low-liquidity investment.

Shares in public companies generally have reasonable liquidity.

Some investments may be 'illiquid' – we can't get our money until a certain date or event (e.g. retirement).

### **Risk**

Risk and reward is the classic investor's balancing act.

The higher the risk we take, the higher returns we could receive, but the more chance we have of our investments losing value, fluctuating in value, or failing entirely.

With a low-risk investment, we generally know the return we will receive right up front.

A bank savings account is a low-risk investment. We know the return (the interest rate), but compared to riskier investments, like shares, it isn't very high.

Higher returns are only available with higher risk. The risks come in two types:

**Volatility:** The possibility that the value of the investment will go up and down.

Performance: The possibility that the investment could fail and we lose all or part of our money – or the investment gives us a lower return than expected or needed. If considering high-risk investments, be sure to balance the risks with other investments in lower risk areas (like short-term deposits, or cash and bonds). Generally, it's easy to recognise high-risk investments because the potential returns also stand out as really high. The promise of too-good-to-be-true returns is probably just that: not true.

## 1.2 Objectives of Investment

Four main **investment objectives** cover how you accomplish most financial goals. These investment objectives are important because certain products and strategies work for one objective, but may produce poor results for another objective. It is quite likely you will use several of these investment objectives simultaneously to accomplish different objectives without any conflict. Let's examine these objectives and see how they differ.

### Capital Appreciation

Capital appreciation is concerned with long-term growth. This strategy is most familiar in retirement plans where investments work for many years inside a qualified plan. However, investing for capital appreciation is not limited to qualified retirement accounts. If this is your objective, you are planning to hold the stocks for many years. You are content to let them grow within your portfolio, reinvesting dividends to purchase more shares. A typical strategy employs making regular purchases. You are not very concerned with day-to-day fluctuations, but keep a close eye on the fundamentals of the company for changes that could affect long-term growth.

### Current Income

If your objective is current income, you are most likely interested in stocks that pay a consistent and high dividend. You may also include some top-quality real estate investment trusts (REITs) and highly-rated bonds. All of these products produce current income on a regular basis. Many people who pursue a strategy of current income are retired and use the income for living expenses. Other people take advantage of a lump sum of capital to create an income stream that never touches the principal, yet provides cash for certain current needs (college, for example).

### Capital Preservation

Capital preservation is a strategy you often associate with elderly people who want to make sure they don't outlive their money. Retired or nearly retired people often use this strategy to hold on to the money. For this investor, safety is extremely important – even to the

extent of giving up return for security. The logic for this safety is clear. If they lose their money through foolish investment and are retired, it is unlikely they will get a chance to replace it. Investors who use capital preservation tend to invest in bank CDs, National Treasury issues and savings accounts.

## **Speculation**

The speculator is not a true investor, but a trader who enjoys jumping into and out of stocks as if they were bad shoes. Speculators or traders are interested in quick profits and use advanced trading techniques like shorting stocks, trading on the margin, options and other special equipment. They have no love for the companies they trade and, in fact, may not know much about them at all other than the stock is volatile and ripe for a quick profit. Speculators keep their eyes open for a quick profit situation and hope to trade in and out without much thought about the underlying companies. Many people try speculating in the stock market with the misguided goal of getting rich. It doesn't work that way. If you want to try your hand, make sure you are using money you can afford to lose. It's easy to get addicted, so make sure you understand the real possibilities of losing your investment.

***The secondary objectives are tax minimization and Marketability or liquidity.***

### **Tax Minimization:**

An investor may pursue certain investments in order to adopt tax minimization as part of his or her investment strategy. A highly-paid executive, for example, may want to seek investments with favorable tax treatment in order to lessen his or her overall income tax burden. Making contributions to an IRA or other tax-sheltered retirement plan can be an effective tax minimization strategy.

### **Marketability/Liquidity:**

Many of the investments we have discussed are reasonably illiquid, which means they cannot be immediately sold and easily converted into cash. Achieving a degree of liquidity, however, requires the sacrifice of a certain level of income or potential for capital gains.

Common stock is often considered the most liquid of investments, since it can usually be sold within a day or two of the decision to sell. Bonds can also be fairly marketable, but some bonds are highly illiquid, or non-tradable, possessing a fixed term. Similarly, money market instruments may only be redeemable at the precise date at which the fixed term ends. If an investor seeks liquidity, money market assets and non-tradable bonds aren't likely to be held in his or her portfolio.

### **Investor types**

#### **1.3 Investment Strategies**

The best thing about investing strategies is that they're flexible. If you choose one and it doesn't suit your risk tolerance or schedule, you can certainly make changes. But be

forewarned: doing so can be expensive. Every purchase carries a fee. More importantly, selling assets can create a realized capital gain. These gains are taxable and therefore, expensive.

Here, we look at four common investing strategies that suit most investors. By taking the time to understand the characteristics of each, you will be in a better position to choose one that's right for you over the long-term without the need to incur the expense of changing course.

## KEY TAKEAWAYS

Before you figure out your strategy, take some notes about your financial situation and goals.

Value investing requires investors to remain in it for the long-term and to apply effort and research to their stock selection.

Investors who follow growth strategies should be watchful of executive teams and news about the economy.

Momentum investors buy stocks experiencing an uptrend and may choose to short-sell those securities.

Rand-cost averaging is the practice of making regular investments in the market over time.

## Take Some Notes

Before you begin to research your investment strategy, it's important to gather some basic information about your financial situation. Ask yourself these key questions:

What is your current financial situation?

What is your cost of living including monthly expenses and debts?

How much can you afford to invest—both initially and on an on-going basis?

Even though you don't need a lot of money to get started, you shouldn't get start if you can't afford to do so. If you have a lot of debts or other obligations, consider the impact investing will have on your situation before you start putting money aside.

Make sure you can afford to invest before you actually start putting money away.

Next, set out your goals. Everyone has different needs, so you should determine what yours are. Are you intending to save for retirement? Are you looking to make big purchases like a home or car in the future? Or are you saving for your or your children's education? This will help you narrow down a strategy.

Figure out what your risk tolerance is. This is normally determined by several key factors including your age, income, and how long you have until you retire. Technically, the younger you are, the more risk you can take on. More risk means higher returns, while lower risk means the gains won't be realized as quickly. But keep in mind, high-risk investments also mean there's a greater potential for losses as well.

Finally, learn the basics. It's a good idea to have a basic understanding of what you're getting into so you're not investing blindly. Ask questions. And read on to learn about some of the key strategies out there.

### **Strategy 1: Value Investing**

Value investors are bargain shoppers. They seek stocks they believe are undervalued. They look for stocks with prices they believe don't fully reflect the intrinsic value of the security. Value investing is predicated, in part, on the idea that some degree of irrationality exists in the market. This irrationality, in theory, presents opportunities to get a stock at a discounted price and make money from it.

It's not necessary for value investors to comb through volumes of financial data to find deals. Thousands of value mutual funds give investors the chance to own a basket of stocks thought to be undervalued. The Russell 1000 Value Index, for example, is a popular benchmark for value investors and several mutual funds mimic this index.

As discussed above, investors can change strategies anytime but doing so—especially as a value investor—can be costly. Despite this, many investors give up on the strategy after a few poor-performing years. In 2014, Wall Street Journal reporter Jason Zweig explained, "Over the decade ended December 31, value funds specializing in large stocks returned an average of 6.7% annually. But the typical investor in those funds earned just 5.5% annually."<sup>1</sup> Why did this happen? Because too many investors decided to pull their money out and run. The lesson here is that in order to make value investing work, you must play the long game.

### **Warren Buffet: The Ultimate Value Investor**

But if you are a true value investor, you don't need anyone to convince you need to stay in it for the long run because this strategy is designed around the idea that one should buy businesses—not stocks. That means the investor must consider the big picture, not a temporary knockout performance. People often cite legendary investor Warren Buffet as the epitome of a value investor. He does his homework—sometimes for years. But when he's ready, he goes all in and is committed for the long-term.

Consider Buffett's words when he made a substantial investment in the airline industry. He explained that airlines "had a bad first century." Then he said, "And they got a bad century out of the way, I hope."<sup>2</sup> This thinking exemplifies much of the value investing approach. Choices are based on decades of trends and with decades of future performance in mind.

## Value Investing Tools

For those who don't have time to perform exhaustive research, the price-earnings ratio (P/E) has become the primary tool for quickly identifying undervalued or cheap stocks. This is a single number that comes from dividing a stock's share price by its earnings per share (EPS). A lower P/E ratio signifies you're paying less per R1 of current earnings. Value investors seek companies with a low P/E ratio.

While using the P/E ratio is a good start, some experts warn this measurement alone is not enough to make the strategy work. Research published in the Financial Analysts Journal determined that "Quantitative investment strategies based on such ratios are not good substitutes for value-investing strategies that use a comprehensive approach in identifying underpriced securities."<sup>3</sup> The reason, according to their work, is that investors are often lured by low P/E ratio stocks based on temporarily inflated accounting numbers. These low figures are, in many instances, the result of a falsely high earnings figure (the denominator). When real earnings are reported (not just forecasted) they're often lower. This results in a "reversion to the mean." The P/E ratio goes up and the value the investor pursued is gone.

If using the P/E ratio alone is flawed, what should an investor do to find true value stocks? The researchers suggest, "Quantitative approaches to detecting these distortions—such as combining formulaic value with momentum, quality and profitability measures—can help in avoiding these 'value traps.'"<sup>3</sup>

### What's the Message?

The message here is that value investing can work so long as the investor is in it for the long-term and is prepared to apply some serious effort and research to their stock selection. Those willing to put the work in and stick around stand to gain. One study from Dodge & Cox determined that value strategies nearly always outperform growth strategies "over horizons of a decade or more." The study goes on to explain that value strategies have underperformed growth strategies for a 10-year period in just three periods over the last 90 years. Those periods were the Great Depression (1929-1939/40), the Technology Stock Bubble (1989-1999) and the period 2004-2014/15.<sup>4</sup>

### Strategy 2: Growth Investing

Rather than look for low-cost deals, growth investors want investments that offer strong upside potential when it comes to the future earnings of stocks. It could be said that a growth investor is often looking for the "next big thing." Growth investing, however, is not a reckless embrace of speculative investing. Rather, it involves evaluating a stock's current health as well as its potential to grow.

A growth investor considers the prospects of the industry in which the stock thrives. You may ask, for example, if there's a future for electric vehicles before investing in Tesla. Or, you may wonder if A.I. will become a fixture of everyday living before investing in a

technology company. There must be evidence of a widespread and robust appetite for the company's services or products if it's going to grow. Investors can answer this question by looking at a company's recent history. Simply put: A growth stock should be growing. The company should have a consistent trend of strong earnings and revenue signifying a capacity to deliver on growth expectations.

A drawback to growth investing is a lack of dividends. If a company is in growth mode, it often needs capital to sustain its expansion. This doesn't leave much (or any) cash left for dividend payments. Moreover, with faster earnings growth comes higher valuations which are, for most investors, a higher risk proposition.

### **Does Growth Investing Work?**

As the research above indicates, value investing tends to outperform growth investing over the long-term. These findings don't mean a growth investor can't profit from the strategy, it merely means a growth strategy doesn't usually generate the level of returns seen with value investing. But according to a study from New York University's Stern School of Business, "While growth investing underperforms value investing, especially over long time periods, it is also true that there are sub-periods, where growth investing dominates."<sup>5</sup> The challenge, of course, is determining when these "sub-periods" will occur.

Interestingly, determining the periods when a growth strategy is poised to perform may mean looking at the gross domestic product (GDP). Take the time between 2000 and 2015, when a growth strategy beat a value strategy in seven years (2007-2009, 2011 and 2013-2015). During five of these years, the GDP growth rate was below 2%. Meanwhile, a value strategy won in nine years, and in seven of those years, the GDP was above 2%. Therefore, it stands to reason that a growth strategy may be more successful during periods of decreasing GDP.

Some growth investing style detractors warn that "growth at any price" is a dangerous approach. Such a drive gave rise to the tech bubble which vaporized millions of portfolios. "Over the past decade, the average growth stock has returned 159% vs. just 89% for value," according to Money magazine's Investor's Guide 2018.<sup>6</sup>

### **Growth Investing Variables**

While there is no definitive list of hard metrics to guide a growth strategy, there are a few factors an investor should consider. Research from Merrill Lynch, for example, found that growth stocks outperform during periods of falling interest rates. It's important to keep in mind that at the first sign of a downturn in the economy, growth stocks are often the first to get hit.

Growth investors also need to carefully consider the management prowess of a business's executive team. Achieving growth is among the most difficult challenges for a firm. Therefore, a stellar leadership team is required. Investors must watch how the team

performs and the means by which it achieves growth. Growth is of little value if it's achieved with heavy borrowing. At the same time, investors should evaluate the competition. A company may enjoy stellar growth, but if its primary product is easily replicated, the long-term prospects are dim.

GoPro is a prime example of this phenomenon. The once high-flying stock has seen regular annual revenue declines since 2015. "In the months following its debut, shares more than tripled the IPO price of R24 to as much as R87," the Wall Street Journal reported.<sup>7</sup> The stock has traded well below its IPO price. Much of this demise is attributed to the easily replicated design. After all, GoPro is, at its core, a small camera in a box. The rising popularity and quality of smartphone cameras offer a cheap alternative to paying R400 to R600 for what is essentially a one-function piece of equipment. Moreover, the company has been unsuccessful at designing and releasing new products which is a necessary step to sustaining growth—something growth investors must consider.

### **Strategy 3: Momentum Investing**

Momentum investors ride the wave. They believe winners keep winning and losers keep losing. They look to buy stocks experiencing an uptrend. Because they believe losers continue to drop, they may choose to short-sell those securities. But short-selling is an exceedingly risky practice. More on that later.

Think of momentum investors as technical analysts. This means they use a strictly data-driven approach to trading and look for patterns in stock prices to guide their purchasing decisions. In essence, momentum investors act in defiance of the efficient-market hypothesis (EMH). This hypothesis states that asset prices fully reflect all information available to the public. It's difficult to believe this statement and be a momentum investor given that the strategy seeks to capitalize on undervalued and overvalued equities.

#### **Does it Work?**

As is the case with so many other investing styles, the answer is complicated. Let's take a closer look.

Rob Arnott, chairman, and founder of Research Affiliates researched this question and this is what he found. "No U.S. mutual fund with 'momentum' in its name has, since its inception, outperformed their benchmark net of fees and expenses."<sup>8</sup>

Interestingly, Arnott's research also showed that simulated portfolios that put a theoretical momentum investing strategy to work actually "add remarkable value, in most time periods and in most asset classes."<sup>8</sup> However, when used in a real-world scenario, the results are poor. Why? In two words: trading costs. All of that buying and selling stirs up a lot of brokerage and commission fees.

Traders who adhere to a momentum strategy need to be at the switch, and ready to buy and sell at all times. Profits build over months, not years. This is in contrast to simple buy-and-hold strategies that take a set it-and-forget it approach.

For those who take lunch breaks or simply don't have an interest in watching the market every day, there are momentum style exchange-traded funds (ETFs). These shares give an investor access to a basket of stocks deemed to be characteristic of momentum securities.

### **The Appeal of Momentum Investing**

Despite some of its shortcomings, momentum investing has its appeal. Consider, for example, that “The MSCI World Momentum Index has averaged annual gains of 7.3% over the past two decades, almost twice that of the broader benchmark.” This return probably doesn't account for trading costs and the time required for execution.

Recent research finds it may be possible to actively trade a momentum strategy without the need for full-time trading and research. Using U.S. data from the New York Stock Exchange (NYSE) between 1991 and 2010, a 2015 study found that a simplified momentum strategy outperformed the benchmark even after accounting for transaction costs. Moreover, a minimum investment of R5,000 was enough to realize the benefits.<sup>9</sup>

The same research found that comparing this basic strategy to one of more frequent, smaller trades showed the latter outperformed it, but only to a degree. Sooner or later the trading costs of a rapid-fire approach eroded the returns. Better still, the researchers determined that “the optimal momentum trading frequency ranges from bi-yearly to monthly”—a surprisingly reasonable pace.<sup>9</sup>

### **Shorting**

As mentioned earlier, aggressive momentum traders may also use short selling as a way to boost their returns. This technique allows an investor to profit from a drop in an asset's price. For example, the short seller—believing a security will fall in price—borrows 50 shares totaling R100. Next, the short seller immediately sells those shares on the market for R100 and then waits for the asset to drop. When it does, they repurchase the 50 shares (so they can be returned to the lender) at, let's say, R25. Therefore, the short seller gained R100 on the initial sale, then spent R25 to get the shares back for a gain of R75.

The problem with this strategy is that there is an unlimited downside risk. In normal investing, the downside risk is the total value of your investment. If you invest R100, the most you can lose is R100. However, with short selling, your maximum possible loss is limitless. In the scenario above, for example, you borrow 50 shares and sell them for R100. But perhaps the stock doesn't drop as expected. Instead, it goes up.

The 50 shares are worth R150, then R200 and so on. Sooner or later the short seller must repurchase the shares to return them to the lender. If the share price keeps increasing, this will be an expensive proposition.

## The Lesson?

A momentum strategy may be profitable, but not if it comes at the limitless downside risk associated with short selling.

### Strategy 4: Rand-Cost Averaging

Rand-cost averaging (RCA) is the practice of making regular investments in the market over time, and is not mutually exclusive to the other methods described above. Rather, it is a means of executing whatever strategy you chose. With RCA, you may choose to put R300 in an investment account every month. This disciplined approach becomes particularly powerful when you use automated features that invest for you. It's easy to commit to a plan when the process requires almost no oversight.

The benefit of the RCA strategy is that it avoids the painful and ill-fated strategy of market timing. Even seasoned investors occasionally feel the temptation to buy when they think prices are low only to discover, to their dismay, they have a longer way to drop.

When investments happen in regular increments, the investor captures prices at all levels, from high to low. These periodic investments effectively lower the average per share cost of the purchases. Putting RCA to work means deciding on three parameters:

The total sum to be invested

The window of time during which the investments will be made

The frequency of purchases

### A Wise Choice

Rand-cost averaging is a wise choice for most investors. It keeps you committed to saving while reducing the level of risk and the effects of volatility. But for those in the position to invest a lump sum, RCA may not be the best approach.

According to a 2012 Vanguard study, "On average, we find that an LSI (lump sum investment) approach has outperformed a RCA approach approximately two-thirds of the time, even when results are adjusted for the higher volatility of a stock/bond portfolio versus cash investments."<sup>10</sup>

But most investors are not in a position to make a single, large investment. Therefore, RCA is appropriate for most. Moreover, a RCA approach is an effective countermeasure to the cognitive bias inherent to humans. New and experienced investors alike are susceptible to hard-wired flaws in judgment. Loss aversion bias, for example, causes us to view the gain or loss of an amount of money asymmetrically. Additionally, confirmation bias leads us to focus on and remember information that confirms our long-held beliefs while ignoring contradictory information that may be important.

Rand-cost averaging circumvents these common problems by removing human frailties from the equation. Regular, automated investments prevent spontaneous, illogical behavior. The same Vanguard study concluded, “If the investor is primarily concerned with minimizing downside risk and potential feelings of regret (resulting from lump-sum investing immediately before a market downturn), then RCA may be of use.”

### **Once You've Identified Your Strategy**

So you've narrowed down a strategy. Great! But there are still a few things you'll need to do before you make the first deposit into your investment account.

First, figure out how much money you need to cover your investments. That includes how much you can deposit at first as well as how much you can continue to invest going forward.

You'll then need to decide the best way for you to invest. Do you intend to go to a traditional financial advisor or broker, or is a passive, worry-free approach more appropriate for you? If you choose the latter, consider signing up with a robo-advisor. This will help you figure out the cost of investing from management fees to commissions you'll need to pay your broker or advisor. Another thing to keep in mind: Don't turn away employer-sponsored 401ks — that's a great way to start investing. Most companies allow you to invest part of your paycheck and tuck it away tax-free and many will match your contributions. You won't even notice because you don't have to do a thing.

Consider your investment vehicles. Remember that it doesn't help to keep your eggs in one basket, so make sure you spread your money around to different investment vehicles by diversifying—stocks, bonds, mutual funds, ETFs. If you're someone who is socially conscious, you may consider responsible investing. Now is the time to figure out what you want your investment portfolio to be made of and what it will look like.

Investing is a roller coaster, so keep your emotions at bay. It may seem amazing when your investments are making money, but when they take a loss, it may be difficult to handle. That's why it's important to take a step back, take your emotions out of the equation and review your investments with your advisor on a regular basis to make sure they're on track.

### **The Bottom Line**

The decision to choose a strategy is more important than the strategy itself. Indeed, any of these strategies can generate a significant return as long as the investor makes a choice and commits to it. The reason it is important to choose is that the sooner you start, the greater the effects of compounding.

Remember, don't focus exclusively on annual returns when choosing a strategy. Engage the approach that suits your schedule and risk tolerance. Ignoring these aspects can lead to a

high abandon rate and frequently changed strategies. And, as discussed above, numerous changes generate costs that eat away at your investment.

## Chapter 2

### Investment Channels

#### Introduction

Given the variety of investment and savings options, their intricacies and your specific needs, it helps to have a suitable financial advisor to unpack it all for you.

'You've got to be in it to win it', as the well-known saying goes, but your financial future shouldn't be a gamble. Just like you should go to see a doctor to take care of your physical needs, the same should be done when it comes to the health of your savings.

It is imperative for one to consult an independent financial advisor to help you achieve your savings goals. The Financial Intermediaries Association of Southern Africa (FIA) maintains that financial advisors are important, given the complex nature of investment and risk products. This makes it "difficult for a consumer to structure a product portfolio that meets all of their needs.

"A good financial advisor will conduct a comprehensive overview of your financial needs and assist in structuring a portfolio of investment and risk products that matches your income and life stage. A financial advisor can offer valuable guidance when critical financial decisions must be taken and often dissuades clients from making ill-thought-out decisions with costly consequences," states the FIA.

The abundance of content and overwhelming media coverage in the public domain on the available investment options out there muddies the water for the layman, making it very difficult to get started. But a licensed (with the Financial Services Conduct Authority) and qualified practitioner will help you navigate the maze of product choices and answer all your questions, including: Should I invest in an exchange-traded fund (ETF) or unit trust? Should I consider investing in the money market or sticking to a tax-free savings account (TFSA)? What retirement product should I choose? Where does offshore investing fit in? Should investors have exposure to all the options or stick to one or two? What about property? How does it all fit together?

If you think it's simply a matter of finding the best performer, that is a mistake. For example, some published unit trust performance tables look at say the five-year return numbers and many investors then select to invest in a unit trust, based on that fact – without considering what the underlying investments are or objectively considering whether the perceived strong returns are likely to continue. Other investors believe "anything other than money in the bank is just 'too risky'" and prefer money market-related investment options. It is just not wise to look at individual products within your portfolio in isolation.

This is where the advice of an advisor becomes invaluable. A good place to start is for you and your planner to take stock of where you stand financially. Assess your goals and what the future might hold and consider your experience and attitudes. Then identify what money is available. The process by which you gather such information is called a 'fact find' – this enables you to be more ready to set up your future financial plan.

The next phase is to determine the time horizon of your investment. You need to think about how soon you need to get your money back. Time frames vary for different goals and will affect the type of risks you can take on. For example, if you're saving for a property deposit and hoping to buy in a couple of years, investments such as local equity funds or offshore portfolios will not be suitable, because their value goes up or down and is considered investments for the longer-term. Stick to cash savings accounts like money market funds or even a TFSA. If you're saving for your pension in 25 years' time, you can ignore short-term falls in the value of your investments and focus on the long term. Over the long term, retirement products, property or collective investment schemes other than cash savings accounts tend to give you a better chance of beating inflation and reaching your pension goal.

Once you're clear on your needs and goals – and have assessed how much risk you can take – draw up an investment plan. This will help you identify the types of products that could be suitable for you. Your advisor will help you understand what is available and what the role of each product is in your overall savings strategy.

Here are some of the options:

**Unit trusts:** You can invest in unit trusts for most of your financial goals, from saving for longer-term needs, to meeting your shorter-term objectives. You can access your money at any time and make changes to your investment whenever you need to, with no transaction fees or penalties.

**ETFs:** You can trade index funds like stocks, which offer the advantage of ETFs being more liquid. They can be bought or sold any time during trading hours and are accessible to smaller investors, because they allow the purchase of individual shares or portions of indices at fractional instalments, while many unit trusts have minimum investments requirements.

**Money market funds:** These vehicles invest in short-term instruments that mature in less than a year. By keeping a short time frame, these funds attempt to reduce risk and provide liquidity.

**Retirement products:** When you invest for retirement, you typically have three main options: a pension fund, a provident fund or a retirement annuity. All have some form of tax benefit and can only be accessed at retirement, so this investment is for the long haul.

**TFSAs:** The new kid on the block is exempt from income tax, dividends tax or capital gains tax on returns. You can only contribute a maximum of R33 000 per tax year (annual limit). There is a lifetime contribution limit of R500 000 per person.

**Offshore portfolios:** The first option is to invest directly offshore in foreign-domiciled funds. When investing in such funds, you are required to convert your rands into your chosen currency. To take the money offshore, you will use your annual discretionary allowance or will be able to apply for tax clearance for an amount up to R10 million.

The second option is to invest indirectly offshore in rand-denominated funds. These funds have mandates to invest in foreign assets. You invest in rands, after which the unit trust management company then converts the rands into foreign currency, using its foreign exchange capacity. All rand-denominated funds are priced in rands.

You can also invest in offshore share portfolios that are managed and reported on locally or via endowments.

**Property** (either actual buildings or listed entities): Buying into property goes much further than just bricks and mortar. You can invest in real estate ETFs or unit trusts, put your money into real estate investment trusts (REITs) or buy shares in a property-focused company. You can even buy a physical property and upgrade it for resale or to buy a building a rent it out per square metre, here or abroad.

This list goes on, and one can drill further into the intricacies of each various asset class. This is proof that one needs a financial advisor to properly unpack it all, and make sure your nest egg is sufficiently diversified. The importance of managing and improving the balance between risk and return, by spreading your money across different investment types and sectors whose prices don't necessarily move in the same direction, cannot be emphasised enough. It can help you smooth out the returns while still achieving growth, and reduce the overall risk in your portfolio, so that one day you can retire in the style you have become accustomed to.

## Article 2

### Types of Saving and Investment Vehicles

July 6, 2020 by Pinyo Bhulipongsanon

Many different financial products can help you achieve your saving and investing goals. Each product is better at meeting specific objectives, while others are better for other purposes. When you start investing, it is a good idea to become familiar with the more common ones. I am an experienced investor, so I know many of these saving and investment vehicles.

**To keep it easier to understand, I categorized investment vehicles into four groups relative to their risk vs. reward potential.**

#### **Cash and Cash Equivalents**

##### **Very Low Risk**

### **Very Low Reward**

These are **very low-risk** investment vehicles that can be easily liquidated into cash, with a mandatory holding period of 12 months or less. They typically provide a very **low return on investment**, and little or no inflation protection. In fact, with the average inflation rate of about 2.5%, these assets are yielding negative real returns, i.e., you have less purchasing power after factoring in inflation.

Our family carries very little cash around, preferring to use our reward credit cards when possible. We do have some money in bank deposit accounts for emergencies and regular expenses.

Here is the list of investments under the **cash and cash equivalents** group:

- Cash
- Savings Accounts
- Certificates of Deposit
- Money Market Accounts and Funds

### **Fixed-Income Investments**

#### **Low Risk**

#### **Low Reward**

Fixed-income investments are **low-risk** and **low-return** investments. When you buy these investments, you are guaranteed regular interest payment plus the return of your principal at the end of the term, assuming the borrower does not default on the loan. If you invest in a fund, your fund could lose value if the interest rate rises. This is called *interest rate risk*.

The only thing we invest in personally from this group is Bond ETFs. We have a small portion of our investment portfolio invested in bonds as part of our asset allocation and diversification strategy.

Here is the list of investments under the **fixed-income investments** group:

- Strip Bonds (Zero-Coupon Bonds) such as Treasury Bills and US Saving Bonds.
- Government Bonds (Treasury Securities) such as Treasury Notes and Treasury Bonds.
- Corporate Bonds, excluding Junk Bonds
- Bonds Mutual Funds and ETFs
- Bankers' Acceptances

### **Equities and Moderate-Risk Investments**

#### **Moderate Risk**

#### **Moderate-High Reward**

The majority of our investments fall into this category of investment vehicles. **They provide the best balance between risk and reward for long-term investing.**

When I was a more active investor, I used to invest more in stocks than mutual funds and ETFs. The majority of my stocks were blue-chip stocks (e.g., DOW and S&P500 stocks).

Now, most of my investments are in low-expense mutual funds and ETFs. Although investing in individual stocks can bring greater rewards, it is also riskier. In the end, I found it better to diversify with funds and ETFs instead.

Although real estate is part of this group, we minimize our investment in REITs because we own our home, plus three rental properties and two real estate private equity investments. Since our real estate portfolio is about 1.5 times our other investments, we figured it would be best to leave real estate out of our investment portfolio.

Here is the list of investments under the **equities and moderate-risk investments** group:  
Stocks, excluding Penny Stocks

Stock Mutual Funds and ETFs  
Real Estate Investment Trusts (REITs)  
Royalty Trusts  
Real Estate Ownership and Rental Properties

### **Speculative Investments and Derivatives**

#### **High Risk**

#### **Moderate-High Reward (Maybe)**

As far as investing goes, we do not utilize any of these investment vehicles in our portfolio due to its high-risk nature. Here is the list of investments under the **speculative investments** group:

Futures Contracts  
Stock Options  
High Yield Bonds (Junk Bonds)  
Peer-to-Peer Lending Notes – These work most similarly to bonds. However, your contract is not with the government or a corporation; instead, your contract is with individuals. In terms of risk vs. reward level, you're probably in the same range as Junk Bonds.  
Penny Stocks (Micro-cap Stocks)  
Inverse Funds and ETFs  
Leveraged Funds and ETFs  
Collectibles, such as antiques, stamps, coins, artworks, etc.  
Foreign Exchange Market (Currency, Forex, or FX)  
Cryptocurrency  
Hedge Funds

#### **Other Investments**

Some investments do not fit well into the groups above. I will highlight some of them here:

**Precious Metals and Gems** – These are mainly stores of value. There is no underlying mechanism or contract that generates value. As such, the value of your investment is entirely dictated by supply and demand, and perhaps, the trendiness of the asset.

**Insurance Products** – There are also “investment” products that are offered by insurance companies. We stay far away from these since there are much better alternatives to these “investments.”

Whole Life Insurance  
Universal Life Insurance

Annuities

Bottom Line

There are many choices when it comes to investment vehicles you can choose to invest in. My personal preference is to stick with the core financial products like savings, checking, CD, money market, stocks, mutual funds, ETFs, bonds, REITs, and real estate. You can do well by focusing on these proven products without ever trying anything else on this list.

## 2.1 Financial Markets

### What Are Financial Markets?

Financial markets refer broadly to any marketplace where the trading of securities occurs, including the stock market, bond market, forex market, and derivatives market, among others. Financial markets are vital to the smooth operation of capitalist economies.

#### 2.1.1 Understanding the Financial Markets

Financial markets play a vital role in facilitating the smooth operation of capitalist economies by allocating resources and creating liquidity for businesses and entrepreneurs. The markets make it easy for buyers and sellers to trade their financial holdings. Financial markets create securities products that provide a return for those who have excess funds (Investors/lenders) and make these funds available to those who need additional money (borrowers).

The stock market is just one type of financial market. Financial markets are made by buying and selling numerous types of financial instruments including equities, bonds, currencies, and derivatives. Financial markets rely heavily on informational transparency to ensure that the markets set prices that are efficient and appropriate. The market prices of securities may not be indicative of their intrinsic value because of macroeconomic forces like taxes.

Some financial markets are small with little activity, and others, like the Johannesburg Securities Exchange (JSE) trade trillions of rand/dollars of securities daily. The equities (stock) market is a financial market that enables investors to buy and sell shares of publicly traded companies. The primary stock market is where new issues of stocks, called initial public offerings (IPOs), are sold. Any subsequent trading of stocks occurs in the secondary market, where investors buy and sell securities that they already own.

Prices of securities traded in the financial markets may not necessarily reflect their true intrinsic value.

## 2.1.2 Types of Financial Markets

### Over-the-Counter Markets

An over-the-counter (OTC) market is a decentralized market—meaning it does not have physical locations, and trading is conducted electronically—in which market participants trade securities directly between two parties without a broker. An OTC market handles the exchange of publicly traded stocks that are not listed on the JSE. In general, companies that trade on OTC markets are smaller than those that trade on primary markets, as OTC markets require less regulation and cost less to use.

### Bond Markets

A bond is a security in which an investor loans money for a defined period at a pre-established interest rate. You may think of a bond as an agreement between the lender and borrower that contains the details of the loan and its payments. Bonds are issued by corporations as well as by municipalities, states, and sovereign governments to finance projects and operations. The bond market sells securities such as notes and bills issued by the United States Treasury, for example. The bond market also is called the debt, credit, or fixed-income market.

### Money Markets (American Context)

Typically the money markets trade in products with highly liquid short-term maturities (of less than one year) and are characterized by a high degree of safety and a relatively low return in interest. At the wholesale level, the money markets involve large-volume trades between institutions and traders. At the retail level, they include money market mutual funds bought by individual investors and money market accounts opened by bank customers. Individuals may also invest in the money markets by buying short-term certificates of deposit (CDs), municipal notes, or U.S. Treasury bills, among other examples.

### Derivatives Market

A derivative is a contract between two or more parties whose value is based on an agreed-upon underlying financial asset (like a security) or set of assets (like an index). Derivatives are secondary securities whose value is solely derived from the value of the primary security that they are linked to. In and of itself a derivative is worthless. Rather than trading stocks directly, a derivatives market trades in futures and options contracts, and other advanced financial products, that derive their value from underlying instruments like bonds, commodities, currencies, interest rates, market indexes, and stocks.

### Forex Market

The forex (foreign exchange) market is the market in which participants can buy, sell, exchange, and speculate on currencies. As such, the forex market is the most liquid market

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in the world, as cash is the most liquid of assets. The currency market handles more than \$5 trillion in daily transactions, which is more than the futures and equity markets combined. As with the OTC markets, the forex market is also decentralized and consists of a global network of computers and brokers from around the world. The forex market is made up of banks, commercial companies, central banks, investment management firms, hedge funds, and retail forex brokers and investors.

## KEY TAKEAWAYS

Financial markets refer broadly to any marketplace where the trading of securities occurs.

There are many kinds of financial markets, including (but not limited to) forex, money, stock, and bond markets.

Financial markets trade in all types of securities and are critical to the smooth operation of a capitalist society.

## 2.2 Understanding the commodity market

A commodity market allows you to trade primary products, the stock market allows you to trade stock in companies that offer manufactured products to consumers. Think of primary products as the raw materials that manufacturers need to create the products that they sell to consumers.

Natural resources like oil are also considered part of the commodities because they are raw resources sold to manufacturers and retailers before hitting the consumer market.

### 2.2.1 Types of commodities

The simplest way to divide the commodities market is to group the primary products in terms of hard or soft commodities. Hard commodities include natural resources like oil and metals.

Soft commodities include most agricultural primary products such as wheat and sugar.

You can then break this down even further to include more specific product categories. You may decide to trade precious metals, such as gold, platinum and silver. There are also other types of metals on the market, including aluminum and copper. You may trade agricultural products such as corn and wheat or venture into livestock trades that may include any animal that is raised and sold as a food source.



Energy is another popular category for commodity trades. This includes crude oil, natural gas and other natural resources used to produce energy around the world.

### **2.2.2 OTC vs. exchange commodity trades**

Over-the-counter, also known as OTC, trades are spot markets designed to allow direct trades of money for primary goods. For example, farmers may participate to negotiate prices for their live cattle. Brokers are used to negotiate prices advantageous to both sides, and the sale of primary products is the result. You won't participate in this type of market unless you are vested in the industry in question.

If you aren't a producer ready to sell a primary product or a buyer interested in securing those products directly from the producer, then you will most likely participate in exchange-based commodity trades. These trades work in a similar fashion to equity trades with the purchase of a standardized contract. You can often trade short and utilize other strategies that you might employ when trading on the stock market or the Forex market with manufactured goods and companies.

One key difference between OTC and exchange trades is that most exchange trades don't result in actual delivery of the primary product. OTC trades are negotiated with the intention of delivering the product to the buyer so that they can create products that are later sold to the consumer market. Equity-based trades are conducted with the intention of generating wealth, so the buyer has no intention of securing the actual product for their use.

### **Research before investing**

The best tip you will ever receive about trading on a commodity market is to research your chosen market thoroughly. If you decide to trade in agricultural products, you need to understand the specific risks and patterns related to those products. This is similar to studying a company before investing in stock on the American stock market or doing your research on currency before entering the Forex market. You have to understand what you're trading if you have any chance of successfully profiting from your investment.

### **2.3 Investing in Real Estate**

Simply stated, when investing in real estate, the goal is to put money to work today and allow it to increase so that you have more money in the future. The profit, or return, you make on your investments must be enough to cover the risk you take, taxes you pay, and the other costs of owning the real estate, such as utilities, regular maintenance, and insurance.

Real estate investing for the beginner can really be as conceptually simple as playing Monopoly once you understand the basic factors of the investment, economics, and risk. To win, you buy properties, avoid bankruptcy, and generate rent so that you can buy even more properties.

However, keep in mind that "simple" doesn't mean "easy." If you make a mistake, the consequences can range from minor inconveniences to major disasters.

### **2.3.1 Ways to Invest in Real Estate**

There are several ways to buy your first real estate investment. If you are purchasing a property, you can use debt by taking a mortgage out against a property. The use of leverage is what attracts many real estate investors because it lets them acquire properties they otherwise could not afford.

Using leverage to purchase real estate can be dangerous because, in a falling market, the interest expense and regular mortgage payments could drive you into bankruptcy if you aren't careful.

To manage risk and protect yourself, consider holding real estate investments through special types of legal entities such as limited liability companies or limited partnerships, rather than in your own name. You should consult with a qualified attorney for their opinion as to which ownership method is best for you and your circumstances.<sup>1</sup>

If the investment goes bust or someone slips and falls, resulting in a lawsuit, these legal entities can protect your personal assets, meaning the worst that could happen is you would lose the money you've invested. You will have peace of mind knowing that your retirement accounts and other assets should be out of reach.<sup>2</sup>

Beyond this, there are other ways to invest in real estate if you don't want to deal with the properties yourself. Real estate investment trusts, or REITs, are particularly popular in the investment community. When you invest through a REIT, you are buying shares of a corporation that owns real estate properties and distributes practically all of its income as dividends.

There are tax complexities—your dividends aren't eligible for the low tax rates you can get on common stocks—but they can be a good addition to your portfolio if purchased at the right value, with a sufficient margin of safety. You can even find a REIT to match your preferred industry; e.g., hotel REITs.

You can also get into more esoteric areas, such as tax lien certificates. Technically, as lending money for real estate is considered real estate investing, it can be considered a fixed-income investment. This is similar to a bond because you generate your investment return by lending money in exchange for interest income.

Likewise, buying a piece of real estate or a building and then leasing it back to a tenant, such as a restaurant, is more akin to fixed income investing rather than a true real estate investment. You are essentially financing a property, although this somewhat straddles the fence between investing and financing. You will eventually own the property, while its appreciation and profits belong to you.

### **2.3.2 Ways to Make Money Investing in Real Estate**

When you invest in real estate, there are several ways you can make money:

#### **Real Estate Appreciation**

This occurs when a property increases in value due to a change in the real estate market. For example, the land around your property could become scarcer or busier, like when a major shopping center is built nearby. Or you could have made upgrades to the property that make it more attractive to potential buyers. Real estate appreciation is a tricky game because it is somewhat unpredictable, making it riskier than investing for cash flow income.

#### **Cash Flow Income**

This type of real estate investment focuses on buying a real estate property, such as an apartment building, and operating it, so you collect a stream of cash from tenant rent. Cash flow income can be generated by other types of real estate besides apartment buildings, such as storage units, office buildings, retail establishments, and rental houses.

#### **Real Estate Related Income**

This income is generated by specialists in the real estate industry, such as real estate brokers, who make money from commissions on properties they have helped a client buy or sell, or real estate management companies, which get to keep a percentage of rents in exchange for running the day-to-day operations of a property.

A hotel management company might keep 15% of a hotel's sales for taking care of the day-to-day operations, such as hiring maids, running the front desk, mowing the lawn, and washing the towels.

#### **Ancillary Real Estate Investment Income**

For some real estate investments, this can be a huge source of profit. Ancillary real estate investment income includes things such as vending machines in office buildings or laundry facilities in rental apartment complexes. In effect, they serve as mini businesses within a bigger real estate investment, letting you make money from a semi-captive collection of customers.

### **2.3.3 Categories of Real Estate Investments**

If you're intent on developing, acquiring, owning, or flipping real estate you, you might come to a better understanding of what you're facing by dividing types of real estate into several categories.

#### **Residential**

Residential structures are properties such as houses, apartment buildings, townhouses, and vacation houses where a person or family pays you to live in the property. The length of their stay is based upon the rental or lease agreement. Most residential leases are on a twelve-month basis in the United States.

### **Commercial**

Commercial properties consist mostly of office buildings and skyscrapers. If you were to take some of your savings and construct a small building with individual offices, you could lease them out to companies and small business owners, who would pay you rent to use the property.

It isn't unusual for commercial real estate to involve multi-year leases. This can lead to greater stability in cash flow, and even protect the owner when rental rates decline. One consideration is that markets do fluctuate, and rental rates could increase substantially over a short period of time. However, it may not be possible to raise rates if commercial property is locked into older agreements.

### **Industrial**

Industrial real estate consists of everything from industrial warehouses, storage units, car washes, or other special purposes real estate that generate sales from customers who use the facility. Industrial real estate investments can often have significant fees and service revenue streams, such as adding coin-operated vacuum cleaners at a car wash, to increase the return on investment for the owner.

### **Retail**

Retail properties consist of shopping malls, strip malls, and other retail storefronts. In some cases, the property owner also receives a percentage of sales generated by the tenant store in addition to a base rent to incentivize them to keep the property in top-notch condition.

### **Mixed-Use**

Mixed-use properties are those that combine any of the above categories into a single project. As an example, an investor in California took several million dollars in savings and found a mid-size town in the Midwest. He approached a bank for financing and built a mixed-use three-story office building surrounded by retail shops.

The bank, which lent him the money, took out a lease on the ground floor, generating significant rental income for the owner. The other floors were leased to a health insurance company and other businesses. The surrounding shops were quickly leased by a Panera Bread, a membership gym, a quick-service restaurant, an upscale retail shop, a virtual golf range, and a hair salon.

Mixed-use real estate investments are popular for those with significant assets because they have a degree of built-in diversification, which is important for controlling risk.

### **2.3.4 Pros and Cons of Real Estate Investing**

#### **Pros**

Less risk and volatility than the stock market

Can be a good source of cash flow

Lots of tax deductions

Properties deliver good long-term return

#### **Cons**

Not as much potential for aggressive return

Can require a lot of cash

Poor liquidity

Dealing with tenants and building issues can be difficult

## Chapter 3

### Investing in Business Ventures

#### Introduction

Are you looking to start a business? There are numerous ways you can structure your new business, which will play a part in how you run it and who you answer to.

If you're a group starting a business together, or one founder going it alone, you should know the benefits and drawbacks of each structural type. Here are the 5 different types of business structures and how they will impact your business:

#### 3.1 Types of Businesses

##### 3.1.1 Sole Proprietorship

A sole proprietorship is when there is a single founder who owns and runs the business. This is the simplest form of business entity because the business is not separate from the owner.

You can give your business a trading name, and only you have the authority to make decisions about your business.

##### Advantages of a sole proprietorship

There are quite a few advantages of sole proprietorship, such as:

It's easier to set up than any of the other business entities.

The owner maintains 100% control and ownership of the business.

The owner is entitled to all of the profits.

##### Disadvantages of a sole proprietorship

There are also disadvantages for sole proprietorship, such as:

You, as the owner, assume all the risk for the business. Your assets will be seized to pay for business debt, and you are personally liable for any obligations.

If you wish to include another owner in your business, you'll have to dissolve the sole proprietorship and form a new business entity.

##### Sole Proprietorship Example

Sole proprietorships are typically smaller, one-man businesses. Once they grow larger, partners come on board or the business is registered as a Pty Ltd. This means that a large portion of global businesses were at one stage sole proprietorships such as:

##### Amazon – Jeff Bezos

In 1994, Bezos resigned from his [six-figure corporate job](#) to pursue his business idea. He wanted to create an online bookstore called Amazon. It was risky, but he was convinced that the internet was the place to grow a business.

He worked out of the garage of his rented house, where he stored, packaged and shipped books to customers. Bezos focused his time upskilling himself on how to source books and developing an online, user-friendly system for his customers.

A year later, he launched with more than a million books, calling itself 'Earth's Biggest Book Store'.

Four years after his first sale, Bezos took the company public and Amazon became a vast online marketplace, making sales of more than USD610 million, with more than 3000 employees and 13 million customers globally.

### **3.1.2. Partnership**

A partnership is when 2 or more co-owners run a business together. Partners will also [pool their money](#) towards a common goal, share specialised skills and resources and share in the ups and downs of business success.

#### **Advantages of having a partner**

Just like with a sole proprietor there are [benefits](#) to having a partner or partners helping you run your business, such as:

With more people comes more knowledge and expertise

You'll have more capital and cash to work with.

You can share the financial burden and expenses of running a business with your fellow partners.

Having partners means there is an even distribution of labour.

You'll have a better work-life balance as there are others to assist you with the workload? and ensuring your business is becoming a success.

#### **Disadvantages of having a partner**

Having more people isn't always a benefit, here are the disadvantages of having partners:

Everyone is liable for debts whether they were caused by other partners or not.

You have to share control of the business with your partner(s)

Dealing with others is not always seamless, there could be a falling out or an argument, which can strain the relationship between you and your partner.

If you ever want to sell your business, this could prove difficult if others don't want to sell.

## Partnership Example

Before a business becomes a global hitter, it can start off as a partnership. Once they grow their business they can register as a Pty Ltd or public company. This business started off as a partnership and grew into one of the most well-known and profitable businesses in the world:

### Apple - Steve Wozniack and Steve Jobs

Partners, Steve Wozniack and Steve Jobs, found they had a mutual love for electronics and become friends. After working together on a project, they proved their partnership successful, they decided to team up and develop a personal computer.

In 1975, they set up shop in Jobs' parents' garage and began developing the prototype named Apple 1. In an effort to raise enough money to launch, Jobs sold his car and Wozniack sold his Hewlett-Packard calculator.

They enlisted the help of a third co-founder Ronald Wayne and began selling the Apple 1. With their profits they improved and refined their design and launched Apple 2 in 1977.

### 3.1.3. Pty Ltd - Proprietary limited company

A private company, Pty Ltd or proprietary limited company is treated as a separate legal entity. So even if you launch your business single-handedly, this type of business is registered as a separate legal entity.

The owners of a Pty Ltd are also known as the shareholders.

### Advantage of being a Pty Ltd

You don't have to explain your finances and decisions to anyone. This is the reason Richard Branson took his company private again after having it public for two years.

The business is a separate entity, so it continues to run smoothly even if you sell your shares or take on partners.

Shareholders are typically not liable for company debts, although there are some tax liabilities.

Anyone acting recklessly or fraudulently can be personally liable for all or any debts of the Pty Ltd.

### Disadvantages of being a Pty Ltd

Although there are a fair amount of benefits, there are also drawbacks to structuring your business as a Proprietary limited company, such as:

Private companies are required to comply with a large number of legal requirements.

This type of business is challenging and expensive to register.

As this is a private company, you can't offer shares to the public or list the business on a stock exchange.

Two shareholders must be at a meeting, except when the company only has one shareholder

All of your financial statements need to undergo annual auditing. There are some exceptions in the new Companies Act, find out more here.

### **Pty Ltd Example**

Although he started out as a sole proprietor and eventually launched as a public company, he ultimately chose to run a private company. Here is an example of a private company:

#### **Virgin - Richard Branson**

After several years of hustling, in 1969, Richard Branson started a mail-order record company. It made enough money for him to expand and open a discounted record store.

He then launched a successful record label, as well as expanding into industries such as trains, mobile phones, banking, bridal wear and gyms and an airline.

"I did not set out to build a business empire. I set out to create something I enjoyed that would pay the bills," says Branson.

#### **3.1.4. Public Company**

A public company is a business that issues securities through an initial public offering (IPO) and trades its stock on at least one stock exchange. The daily trading of the public company's stock determines the value of the whole business.

Publicly traded companies are defined as public because, unlike Pty Ltd businesses, shareholders can be anyone who purchases stock. Anyone can then become equity owners of the business.

#### **Advantage of publicly traded companies**

Just like any other type of business structure, a public company has benefits, such as:

Since you can sell your shares to the public, this offers you more capital to work with.

Being listed on a stock exchange means that fund managers and traders are keeping an eye on your business. The more interest you have, the more business opportunities will come your way.

The risk is spread out amongst the various shareholders. The more shareholders, the less risk everyone holds.

#### **Disadvantages of publicly traded companies**

Here are the disadvantages of this type of business structure:

Setting up a public company is more challenging compared to the other types of business structures.

Since there are now more shareholders, directors and managers, making decisions can take significantly longer.

You'll need to reveal some of your documents and annual accounts are published for inspection to the public. This improves transparency but doesn't enable you to guard your secrets effectively.

When you go public, you're selling the ownership of your company to strangers. It's challenging to raise the money you need while keeping a 51% majority.

### **Public Company Example**

Many internationally recognisable businesses started out as a partnership, this business is no different. Today it is one of many publicly traded companies on the New York Stock Exchange.

### **Facebook – Mark Zuckerberg**

In 2004, Mark Zuckerberg, Eduardo Saverin, Dustin Moskovitz, and Chris Hughes, founded Facebook while studying at Harvard University. Facebook has since become the largest social network in the world, with 2.38 billion monthly active users.

In 2012, Facebook filed to become a public company. Its initial public offering raised \$16 billion, giving it a market value of \$102.4 billion. At the end of the first day of trading, Mark Zuckerberg's holdings were estimated at more than \$19 billion.

### **3.1.5. Franchise**

A franchise is when the owner of a business licenses their business to a third party. This gives you the right to operate the business or distribute goods and/or services using the business's name and systems, for a fee.

#### **Advantage of operating a franchise**

Typically, a franchise has a successful track record and a positive reputation that you can capitalise on.

Franchises offer training programmes designed to optimise how you run the business and bring you up to speed quickly.

If you join a franchise, they also offer ongoing operational support. This ensures you're not alone when building and growing your business.

#### **Disadvantages of operating as a franchise**

Buying into a franchise also comes with its own set of issues and drawbacks, such as:

If you've bought into a franchise, you'll have to follow the rules, regulations, system operations and directives of the franchise.

The cost of becoming a franchisee can be high, sometimes even higher than starting your own business.

You'll have to pay royalties to the franchise for the use of their name and systems.

### **Franchise Example - McDonald's**

McDonald's started out as a partnership between the two McDonald's brothers. Since then it has franchised across the world, opening over 36 000 restaurants and operates in over 100 countries and territories.

Now it is one of the most popular international fast-food chains. Their popularity amongst new franchisees has to do with their extensive training and support, to continue to offer consistency across every business no matter where in the world.

McDonald's restaurants serve over 68 million people every day, that's more than the entire population of South Africa.

### **3.2 What type of business should you start?**

Your needs and the needs of your business will determine which type of business structure will be the best for you. Feel free to switch between types as your business grows.

When starting a business, you can register as a sole proprietor or partnership and eventually grow into a Pty Ltd or public company. Use the different types of business structures to your and your business's advantage.

## **3.3 Utilising a Business Plan**

### **3.3.1 What is a business plan?**

If you've ever jotted down a business idea on a napkin with a few tasks you need to accomplish, you've written a business plan—or at least the very basic components of one. **At its heart, a business plan is just a plan for how your business is going to work, and how you're going to make it succeed.**

#### **How long should your plan be?**

Typically, a business plan is longer than a list on a napkin (although, as you'll see below, it is possible—and sometimes ideal—to write your entire business plan on one page). For me in practice, and for most real businesses, it can be as simple as the Lean Plan that has a few

bullet points to focus strategy, tactics, milestones to track tasks and responsibilities, and the basic financial projections you need to plan: cash flow, budget, expenses.

### **How should you present your business plan?**

A note on format: business plans should only become printed documents on select occasions, like when you need to share information with outsiders or team members. Otherwise, they should be dynamic documents that you maintain on your computer.

The plan goes on forever, meaning that you're constantly tweaking it, because you're regularly evaluating your business health, so the printed version is like a snapshot of what the plan was on the day that it was printed.

### **What does a formal plan include?**

If you do need a formal business plan document, then that includes elements like:

An executive summary

A company overview

Some information about your products and/or services

Your marketing plan

A list of major company milestones

Some information about each member of the management team and their role in the company

Details of your company's financial plan

These are often called the "sections" or "chapters" of the business plan, and I'll go into much greater depth about each of them below.

### **How often should you revise your business plan?**

In all cases, the most important element of business planning is the review schedule—set specific times to review your progress toward your goals. That's as simple as "the third Thursday of every month" to cite one obvious example.

Specifically, it's the time to review your progress on milestones and to compare your actuals against your financial projections. A real business plan is always wrong—hence the regular review and revisions—and never done, because the process of review and revising is vital.

### **3.3.2 Who needs a business plan?**

If you're just planning on picking up some freelance work to supplement your income, you can skip the business plan. But, if you're embarking on a more significant endeavor that's

likely to consume a significant amount of time, money, and resources, then you need a business plan.

If you're serious about business, taking planning seriously is critical to your success.

Unfortunately, many people think of business plans only for starting a new business or applying for business loans. But business plans are also vital for running a business—strategic planning—whether or not it needs new loans or new investments. Existing businesses should have business plans that they maintain and update as market conditions change and as new opportunities arise.

Every business has long-term and short-term goals, sales targets, and expense budgets—a business plan encompasses all of those things and is as useful to a startup trying to raise funds as it is to a 10-year-old business that's looking to grow.

### **1. Startup businesses**

The most classic business planning scenario is for a startup, for which the plan helps the founders break uncertainty down into meaningful pieces, like the sales projection, expense budget, milestones, and tasks.

The need becomes obvious as soon as you recognize that you don't know how much money you need, and when you need it, without laying out projected sales, costs, expenses, and timing of payments. And that's for all startups, whether or not they need to convince investors, banks, or friends and family to part with their money and fund the new venture.

In this case, the business plan is focused on explaining what the new company is going to do, how it is going to accomplish its goals, and—most importantly—why the founders are the right people to do the job. A startup business plan also details the amount of money needed to get the business off the ground, and through the initial growth phases that will lead (hopefully!) to profitability.

### **2. Existing businesses**

Not all business plans are for startups that are launching the next big thing. Existing businesses use business plans to strategically manage and steer the business, not just to address changes in their markets and to take advantage of new opportunities. They use a plan to reinforce strategy, establish metrics, manage responsibilities and goals, track results, and manage and plan resources including critical cash flow. And of course, they use a plan to set the schedule for regular review and revision.

Business plans can be a critical driver of growth for existing businesses. Did you know that businesses that write plans and use them to manage their business grow 30 percent faster than businesses that take a “seat of the pants” approach? A study by Professor Andrew Burke, the founding Director of the Bettany Centre for Entrepreneurial Performance and Economics at Cranfield School of Management, discovered exactly this.

For existing businesses, a robust business planning process can be a competitive advantage that drives faster growth and greater innovation. Instead of a static document, business plans in existing businesses become dynamic tools that are used to track growth and spot potential problems before they derail the business.

### **3.3.3 Choosing the right kind of business plan for your business**

Considering that business plans serve many different purposes, it's no surprise that they come in many different forms.

Before you even start writing your business plan, you need to think about who the audience is and what the goals of your plan are. While there are common components that are found in almost every business plan, such as sales forecasts and marketing strategy, business plan formats can be very different depending on the audience and the type of business.

For example, if you're building a plan for a biotech firm, your plan will go into details about government approval processes. If you are writing a plan for a restaurant, details about location and renovations might be critical factors. And, the language you'd use in the biotech firm's business plan would be much more technical than the language you'd use in the plan for the restaurant.

Plans can also differ greatly in length, detail, and presentation. Plans that never leave the office and are used exclusively for internal strategic planning and management might use more casual language and might not have much visual polish.

On the other end of the spectrum, a plan that is destined for the desk of a top venture capitalist will have a high degree of polish and will focus on the high-growth aspects of the business and the experienced team that is going to deliver stunning results.

### **3.3.4 Three common types of plans:**

#### **One-page business plan**

A one-page business plan is exactly what it sounds like: a quick summary of your business delivered on a single page. No, this doesn't mean a very small font size and cramming tons of information onto a single page—it means that the business is described in very concise language that is direct and to-the-point.

A one-page business plan can serve two purposes. First, it can be a great tool to introduce the business to outsiders, such as potential investors. Since investors have very little time to read detailed business plans, a simple one-page plan is often a better approach to get that first meeting. Later in the process, a more detailed plan will be needed, but the one-page plan is great for getting in the door.

This simple plan format is also great for early-stage companies that just want to sketch out their idea in broad strokes. Think of the one-page business plan as an expanded version of

jotting your idea down on a napkin. Keeping the business idea on one page makes it easy to see the entire concept at a glance and quickly refine concepts as new ideas come up. Learn more about how to create a one-page business plan.

### **The Lean Business Plan**

A Lean Plan is more detailed than a one-page plan and includes more financial information, but it's not as long as a traditional business plan. Lean Plans are more likely to be used internally as tools for strategic planning and growth.

The Lean Business Plan dispenses with the formalities that are needed when presenting a plan externally for a loan or investment and focuses almost exclusively on business strategy, tactics, milestones, metrics, budgets, and forecasts.

These lean business plans skip sections like company history and management team since everyone in the company almost certainly knows this information. You don't do an exit strategy section of your business plan if you're not writing for investors and therefore you aren't concerned with an exit.

The simplest lean business plan uses bullet points to define strategy, tactics, concrete specific dates and tasks, and essential numbers including projected sales, spending, and cash flow. It's just five to 10 pages when printed. And few Lean Plans need printing. Leave them on the computer. Review and revise them at least once a month. The first Lean Plan takes just a few hours to do (or less), and a monthly review and revision can take only an hour or two per month.

Lean business plans are management tools used to guide the growth of both startups and existing businesses. They help business owners think through strategic decisions and measure progress towards goals.

### **External business plan (a.k.a the standard business plan document)**

External business plans, the formal business plan documents, are designed to be read by outsiders to provide information about a business. The most common use of a full business plan is to convince investors to fund a business, and the second most common is to support a loan application. Occasionally this type of business plan is also used to recruit or train or absorb key employees, but that is much less common.

A formal business plan document is an extension of the internal business plan or the Lean Plan. It's mostly a snapshot of the internal plan as it existed at a certain time. But while an internal plan is short on polish and formality, a formal business plan document should be very well-presented, with more attention to detail in the language and format. See example business plans in our sample plan library to give you an idea of what the finished product might look like.

In addition, an external plan details how potential funds are going to be used. Investors don't just hand over cash with no strings attached—they want to understand how their funds will be used and what the expected return on their investment is.

Finally, external plans put a strong emphasis on the team that is building the company. Investors invest in people rather than ideas, so it's critical to include biographies of key team members and how their background and experience is going to help grow the company.

Article 3:

### **How to Write an Effective Executive Summary**

Planning By: Tim Berry

#### **What is an executive summary?**

An executive summary is a brief introduction and summary of your business plan. It should describe your business, the problem that it solves, your target market, and financial highlights.

A good executive summary grabs your reader's attention and lets them know what it is you do and why they should read the rest of your business plan or proposal. It's not unusual for investors to make an initial decision just based on reading an executive summary, so it's important to get it right. We'll show you how to write an executive summary that sets your business plan apart from the rest.

#### **Is an executive summary necessary?**

Are you writing a business plan to show to investors or bankers? Then you need a good executive summary. Many people will read only the summary, no matter what. Others will read the summary first to decide whether or not they read the rest of the plan. The executive summary is essential in plans that are being written for outsiders.

Now if you're writing a business plan solely for internal use you may not need to write out an executive summary. However, there are some internal plans—such as an annual operations plan or a strategic plan—that can use a summary to highlight necessary information and showcase a digestible version of the overall plan.

It takes some effort to do a good summary, so if you don't have a business use for the summary, don't do it.

#### **How long should an executive summary be?**

The general rule of thumb is that executive summaries should be as short as possible. Your audience has limited time and attention and they want to get the details of your business plan as quickly as possible.

Try to keep your executive summary under 2 pages if possible, although it can be longer if absolutely necessary.

You might even be able to write it on one page using a Lean Plan format.

#### **1. A description of your product or service and the problem your business solves**

Include a brief description of the product or service you offer and why it's necessary.

Your business doesn't need to serve a larger social problem, but it should address a need for customers or an opportunity in the market.

#### **2. A description of your target market**

Your target market is who you think your customers will be. Sometimes the product name itself defines the market, such as “Peoria’s Best Thai food,” or “Mini Cooper Dashboard Accessory.” If not, then a brief description of the target market—your primary audience, or the people you think will spend money on your solution will suffice.

### **3. Competition**

Assuming your business has competition (every business does!), then briefly describe how your business will differentiate itself. Are you competing on price, quality, or something else? Briefly describe what makes your business different here.

### **4. Financial Overview**

If you’re an existing company, this might be as simple as highlighting recent annual sales and growth over the last year. For a startup, it might be a brief description of aspirations, such as a sales forecast goal for the next year or three years from now. I often recommend a simple highlights chart, a bar chart with sales and gross margin for the next three years.

### **5. Your Team**

This is especially important for startup companies. Investors want to know who is behind the business idea and why you and your team are the right people to build the business. It also may be valuable to highlight any gaps in your team and how you intend to fill them. If you have potential partners or candidates in mind, briefly mention them and expand on their qualifications within your full business plan.

### **6. Funding Needs**

If you are using your business plan to raise money for your business, your executive summary should highlight how much money you are looking for. Investors will want to know this upfront and not have to dig through a business plan to find this detail.

#### **Other topics your executive summary may need to cover**

##### **Evidence of early success**

If you are a young startup and you’re writing a business plan to raise money, you will want to include evidence of “traction” in your executive summary. This can include results from consumer surveys, pre-order numbers for your product/service or even early sales numbers if you did a soft open or limited time release. It doesn’t have to be much, but any early success provides proof that your business model, product/service and market research are well-founded.

##### **Future Milestones**

You may also want to discuss future milestones that your business hopes to achieve. This is particularly important for businesses within a highly saturated or complex industry, such as medical device manufacturers and drug companies, for example. They need to explain where they are in the process of getting regulatory approvals and what steps remain.

##### **Evidence of Financial Stability**

If you’re seeking a bank loan, bankers will be looking for evidence of your financial stability, including your net worth, assets, and financial history. Read on for tips on writing an executive summary for each of those scenarios.

#### **Tips for writing an executive summary for investors**

Before you develop your executive summary for seeking investment, understand how it fits into your business plan. The executive summary can be the first section of your business plan, or you might be developing a stand-alone executive summary that you plan on handing out without the rest of the plan.

My views on this are taken from eight years as an active member in an angel investment group, and more than 10 actual angel investments, plus membership in the Angel Capital Association.

#### **Investors use executive summaries to screen opportunities**

A well-prepared executive summary is useful for angel investment platforms like Gust, AngelList, and others to gauge interest in candidates. Introductions lead to requests for email summaries, not full business plans, so you'll want to have an executive summary ready to go that causes investors to want to see the full thing.

#### **Investors need the full business plan to complete due diligence when reviewing candidates**

We've never invested in a business that didn't have a business plan and your executive summary is the key to having your business plan reviewed. The full reading of the complete business plan comes only later in the process after we've screened summaries down to a very few that are interesting enough to do due diligence.

Of the group I work with, for example, three-fourths of us will read every executive summary submitted to us. All of us will read summaries for plans that pique group interest, and half of us will look at the rest of the plan only if we are still interested after reading the summary.

#### **Mention previous startup experience, or specific industry expertise**

Let the investors know about any previous startup experience or specializations from the start because this makes a huge difference. Investors often say "bet on the jockey, not just the horse." Keep it brief, just a reference to more information to come later, but make sure you're able to back up your claims later on.

#### **Outline how much money you intend to raise and how it will be spent**

It's a summary, so details will come later, but investors want to know quickly whether your startup is in their normal range of interest and the use of funds makes a difference, too. Spending to build inventory for existing orders, for example, is way less risky than spending to develop a product that is in design and prototyping.

Valuation, in this context, is controversial. Valuation is what you say your company is worth, a number that determines how much ownership you give away for investment. Some investors want summaries to specify how much money at what valuation; others want to assign the valuation themselves and don't like startups pushing their number too early.

#### **Mention your exit strategy**

Leave the details for later, but investors want to know that you understand they don't make money unless you achieve an exit in a few years so they can sell shares to get their return. Too many founders think investors just want them to be successful, when in fact that means very little without an eventual exit.

#### **Be persuasive, but focus on the facts**

You want to make your prospective investor want to keep reading; convince them to invest in your startup. But do understand that the persuasion is in the facts, not in the wording. What keeps them interested is the content of the summary, not the tone. Facts that prove traction, potential market, or startup experience are infinitely more powerful than mere assertions of excellence.

### **Avoid obvious clichés**

There are severely obvious pitfalls that you can fall into if you're not careful. For example, never mention the team's passion or commitment—they all have that, so it's irrelevant. If you say that your startup is disruptive, or game-changing, or the next Facebook or whatever, you lose. Instead, show that with facts and let the investors say it, not you.

### **Tips for writing an executive summary for a bank loan**

Contrary to the common misconception, bankers don't ever take risks on business plans. To get bankers to read on, the executive summary has to cover the six main points suggested in the beginning of this article, plus a few selected other points that highlight stability, assets on the balance sheet, and financial history, showing that the loan is not risky. **With one notable exception, banking law forbids banks lending money to businesses that don't have enough assets to cover the full value of the loan, and then some.** That's against banking regulations.

Good professional bankers ask for a business plan as part of a loan application because they legitimately want to know and understand your business, but they don't take risks. This summary isn't about persuading or selling, but rather reassuring and describing. So what works for the executive summary for bankers is quite different from what works for the summary for investors.

### **Outline your personal net worth**

Where investors want to see management team startup experience, bankers want to see the personal net worth of business owners. The more collateral, savings or other investment you have available, the more likely you are to secure the loan.

### **Be transparent about your financial history and bankable assets**

Where investors want to see future potential growth, bankers want to see past financial history and bankable assets. Try to have every piece of financial information about yourself, current investors and any past businesses available upfront.

### **Give evidence of your potential stability and longevity**

Where investors want to look at possible exits, bankers want their commercial borrowers to offer future stability. You don't need to have exact numbers, but developing a financial forecast that defines growth, future cash flow, costs and sales over the next 1-3 years can serve as evidence for stability.

### **6 Tips for writing an effective executive summary**

No matter why you're writing your executive summary, there are some general rules of thumb that make it easier, and ultimately more effective. Here are a few to keep in mind as you get started:

#### **1. Think of an executive summary as a pitch**

Think of an executive summary as being a lot like an elevator pitch, but with constraints. A good summary sells the rest of the plan, but it can't be just a hard sell—it has to

actually summarize the plan. Readers expect it to cover your business, product, market, and financial highlights, at the very least (see below for more detail on this). Of course, you'll highlight what will most spark the reader's interest, to achieve this plan's immediate business objective. But your readers expect the key points covered. It's a summary, not just a pitch.

## **2. Write it last**

Don't start writing your business plan with your summary. Even though the executive summary is at the beginning of a finished business plan, many experienced entrepreneurs (including me) choose to write the executive summary after they've written everything else.

Ideally, the executive summary is short—usually just a page or two, five at the outside—and highlights the points you've made elsewhere in your business plan, so if you save it for the end, it will be quick and easy.

## **3. Keep your executive summary short**

Be brief and concise. I know experts who recommend a single page, just a page or two, no more than five, and sometimes even longer. I say less is more. Keep it as short as you can without missing any essentials. And—I can't resist, because I read hundreds of plans every year—one page is better than two, and two is better than five, and longer than five pages (my opinion here) is too long.

## **4. Keep it simple**

Form follows function, so don't over-complicate or over-explain things in your summary. Most executive summaries are short texts, often with bullets, broken into subheadings. Illustrations such as a picture of a product, or a bar chart showing financial highlights, are usually a welcome addition.

## **5. Prioritize sections based on importance and strengths**

Don't bury the lead. Organize your executive summary so that the most important information appears first. There is no set order of appearance of the different key items included, quite the contrary, in fact—so use the order to show emphasis.

Lead with what you want to get the most attention, and follow with items in the order of importance. I tend to like summaries that start with stating a problem because that can add drama and urgency that tees up the solution in your business.

## **6. Use it for your summary memo**

When it's finished, repurpose it as a summary memo. It's the first chapter of a formal plan, but you can also use it as a stand-alone "summary memo." Investors often ask startups to send a summary memo instead of a full business plan.

It might be a short document, often attached to an email, or simply a summary in an email. You can also use it again to fill in startup profiles on investment platforms such as Gust and AngelList or to apply for an incubator or a business plan competition.

## Additional Reading

### Article- Money Market Vs. Capital Market: What's the Difference?

By CHRISTINA MAJASKI

Updated Apr 19, 2019

Money Market Vs. Capital Market: An Overview

<https://www.investopedia.com/articles/investing/052313/financial-markets-capital-vs-money-markets.asp>

The money market and the capital market are not single institutions but two broad components of the global financial system.

The money market is the trade in short-term debt. It is a constant flow of cash between governments, corporations, banks, and financial institutions, borrowing and lending for a term as short as overnight and no longer than a year.

The capital market encompasses the trade in both stocks and bonds. These are long-term assets bought by financial institutions, professional brokers, and individual investors.

Together, the money market and the capital market comprise a large portion of what is known as the financial market.

Financial Markets: Capital vs. Money Markets

The Money Market

The money market is a good place for individuals, banks, other companies, and governments to park cash for a short period of time, usually one year or less. It exists so that businesses and governments that need cash to operate can get it quickly at a reasonable cost, and so that businesses that have more cash than they need can put it to use.

#### KEY TAKEAWAYS

The money market is a short-term lending system. Borrowers tap it for the cash they need to operate from day to day. Lenders use it to put spare cash to work.

The capital market is geared toward long-term investing. Companies issue stocks and bonds to raise money to grow their businesses. Investors buy them to share in that growth.

The money market is less risky than the capital market while the capital market is potentially more rewarding.

The returns are modest but the risks are low.

The instruments used in the money markets include deposits, collateral loans, acceptances, and bills of exchange. Institutions operating in the money markets include the Federal Reserve, commercial banks, and acceptance houses.

When a company or government issues short-term debt, it's usually to cover routine operating expenses or supply working capital, not for capital improvements or large-scale projects.

#### About Liquidity

The money market plays a key role in ensuring that banks, other companies, and governments maintain the appropriate level of liquidity on a daily basis, without falling short and needing a more expensive loan and without hoarding excess cash that isn't earning interest.

Individual investors may use the money markets to invest their savings in a safe and accessible place. Many choices are available, including mutual funds that focus on state money market funds, municipal funds, and U.S. Treasury funds. Many of the government funds are tax-free. A money-market fund also can be opened at most banks.

#### The Capital Market

The capital market is where stocks and bonds are traded. Its movements from hour to hour are constantly monitored and analyzed for clues to the health of the economy at large, the status of every industry in it, and the consensus for the short-term future.

The overriding goal of the companies institutions that enter into the capital markets is to raise money for their long-term purposes, which usually come down to expanding their businesses and increasing their revenues. They do this by issuing stock shares and by selling corporate bonds.

#### Primary and Secondary

The capital market is roughly divided into a primary market and a secondary market. A company that issues a round of stock or a new bond places it in the primary market for sale directly to investors or institutions. If and when those buyers decide to sell their shares or bonds, they do so on the secondary market. The original issuer of those stocks or bonds does not immediately benefit from their resale, although companies certainly have an interest in the price of their stock shares rising over time.

The capital market is by nature riskier than the money market and has greater potential gains and losses.

## Article- Debt Market vs. Equity Market: What's the Difference?

By J.B. MAVERICK

Updated Jun 25, 2019

Debt Market vs. Equity Market: An Overview

<https://www.investopedia.com/ask/answers/071415/what-are-differences-between-debt-and-equity-markets.asp>

Debt market and equity market are broad terms for two categories of investment that are bought and sold.

The debt market, or bond market, is the arena in which investment in loans are bought and sold. There is no single physical exchange for bonds. Transactions are mostly made between brokers or large institutions, or by individual investors.

The equity market, or the stock market, is the arena in which stocks are bought and sold. The term encompasses all of the marketplaces such as the New York Stock Exchange (NYSE), the Nasdaq, and the London Stock Exchange (LSE), and many others.

The equity market is viewed as inherently risky while having the potential to deliver a higher return than other investments.

### Debt Market

Investments in debt securities typically involve less risk than equity investments and offer a lower potential return on investment. Debt investments by nature fluctuate less in price than stocks. Even if a company is liquidated, bondholders are the first to be paid.

Bonds are the most common form of debt investment. These are issued by corporations or by the government to raise capital for their operations and generally carry a fixed interest rate. Most are unsecured but are issued with a rating by one of several agencies such as Moody's to indicate the likely integrity of the issuer.

### Risky Real Estate and Mortgage-Backed Debt

Real estate and mortgage debt investments are other large categories of debt instruments. Here, the underlying asset securing the debt is real estate known as the collateral. Many real estate- and mortgage-backed debt securities are complex in nature and require the investor to be knowledgeable of their risks.

### The Changing Value of Fixed-Rate Bonds

It is reasonable to ask why a fixed-rate investment can change in value. If an individual investor buys a bond, it will pay a set amount of interest periodically until it matures, and then can be redeemed at face value. However, that bond might be resold in the debt market, called the secondary market.

The bond retains its face value at maturity. However, its real yield, or net profit, to a buyer change constantly. It loses yield by the amount that has already been paid in interest. The investment value increases or decreases with the constant fluctuations in the going interest prices offered by newly-issued bonds. If the interest rate of return on the bond is higher than the going rate, and the bond a reasonable time until maturity, the value may be at par or above the face value.

Thus, in the secondary market, the bond will sell at a discount to its face value or a premium to its face value.

### Equity Market

Equity, or stock, represents a share of ownership of a company. The owner of an equity stake may profit from dividends. Dividends are the percentage of company profits returned to shareholders. The equity holder may also profit from the sale of the stock if the market price should increase in the marketplace.

The owner of an equity stake can also lose money. In the case of bankruptcy, they may lose the entire stake.

The equity market is volatile by nature. Shares of equity can experience substantial price swings, sometimes having little to do with the stability and good name of the corporation that issued them.

Volatility can be caused by social, political, governmental, or economic events. A large financial industry exists to research, analyze, and predict the direction of individual stocks, stock sectors, and the equity market in general.

The equity market is viewed as inherently risky while having the potential to deliver a higher return than other investments. One of the best things an investor in either equity or debt can do is to educate themselves and speak to a trusted financial advisor.

### KEY TAKEAWAYS

In the equity market, investors and traders buy and sell shares of stock.

Stocks are stakes in a company, purchased to profit from company dividends or the resale of the stock.

In the debt market, investors and traders buy and sell bonds.

Debt instruments are essentially loans that yield payments of interest to their owners.

Equities are inherently riskier than debt and have a greater potential for big gains or big losses.

## Article- An Introduction To Securities Market Structures

By JOSEPH NGUYEN

Updated Jul 13, 2020

<https://www.investopedia.com/articles/stocks/11/securities-market-introduction.asp>

The global securities market has been constantly evolving over the years to better serve the needs of traders and investors alike. Traders require liquid markets with minimal transaction and delay costs in addition to transparency and assured completion of the transaction. Based on these core requirements, a handful of securities market structures have become the dominant trade execution structures in the world.

### KEY TAKEAWAYS

While it may seem that all markets are similar in that they match buyers and sellers at a particular price, markets can be structured in various ways.

Order-driven markets display all bids and offers available, while quote-driven markets focus solely on the bids and asks of market makers or specialists.

Brokered markets do not display active bids and offers, but rely on a middleman to acquire quotes for interested parties.

### Quote-Driven Markets

Quote-driven markets are electronic stock exchange systems where buyers and sellers engage in transactions with designated market makers or dealers. This structure only posts the bid and ask quotes for specific stocks dealers are willing to trade.

In a purely quote-driven market structure, traders must interact directly with dealers, who supply liquidity in the market. That's why this structure is well-suited for illiquid markets. Dealers can provide liquidity to securities by maintaining an inventory of those that are thinly traded or trade at low volumes. By providing liquidity, dealers make money from the spread between the bid and ask quotes. To generate profits, they try to buy low at the bid and sell high at the ask, and have high turnover.

Because dealers need to meet the bid and ask prices they quote, order execution on trades is guaranteed. Some dealers may refuse to make trades, however, as they may only work with special clients like institutional ones.

This market structure is commonly found in over-the-counter (OTC) markets such as bond markets, the forex market, and some equity markets. The Nasdaq and London SEAQ (Stock Exchange Automated Quotation) are two examples of equity markets which have roots in a quote-driven market structure. The Nasdaq structure, it is worth noting, also contains aspects of an order-driven market.

Quote-driven markets are also called dealer markets or price-driven markets.

### Order-Driven Markets

In order driven markets, buyers and sellers post the prices and amounts of the securities they wish to trade by themselves rather than through a middleman like a quote-driven market.

Most order-driven markets are based on an auction process, where buyers are looking for the lowest prices and sellers are looking for the highest prices. A match between these two parties results in a trade execution. Order execution in this market structure is not guaranteed as traders are not required to meet the bid or ask prices they quote. Price discovery is determined by the limit order of traders in the particular security.

There are two main types of order-driven markets, a call auction, and a continuous auction market. In a call auction market, orders are collected during the day and at specified times an auction takes place to determine the price. A continuous market, though, operates continuously during trading hours with trades executed whenever a buy and sell order match up.

The biggest benefit of an order-driven market in liquid markets is the large number of traders willing to buy and sell securities. The larger the number of traders in a market, the more competitive the prices become. This theoretically translates into better prices for traders. Transparency is also a big benefit because investors have access to the entire order book. This is the electronic list of buy and sell orders for a specific security. The one major downfall with this structure is that liquidity can be poor in securities with few traders.

The Toronto Stock Exchange (TSX) in Canada is one example of an order-driven market.

### Hybrid Markets

The third market structure we explore in this list is the hybrid market, also known as a mixed-market structure. It combines features from both a quote-driven market and an order-driven market, blending together a traditional floor broker system with an electronic trading platform — the latter being much faster.

The choice is up to investors how they do business and place their trade orders. Choosing the automated electronic system means much faster trades which can take less than a second to complete. Broker-initiated trades from the trading floor, though, can take longer — sometimes as long as nine seconds.

The New York Stock Exchange (NYSE) is one of the world's leading hybrid markets. Originally an exchange that allowed human brokers to make trades manually on the trading floor, it moved beyond that after 2007, allowing the majority of stocks to be traded electronically. Brokers can still make trades manually, but the majority of trades today are executed through the exchange's electronic systems. The NYSE also continues to use dealers to provide liquidity, in the event of low liquidity periods.

### Brokered Markets

The final market structure we'll look at in this article is the brokered market. In this market, brokers or agents act as middlemen to find buyers or counterparties for a transaction. This market usually requires the broker to have some degree of expertise in order to complete the sale or trade.

When a client asks their broker to fill an order, the broker will search their network for a suitable trading partner. Brokered markets are often only used for securities with no public market such as unique or illiquid securities, or both. Common uses of the brokered markets are for large block trades in bonds or illiquid stocks.

The direct real estate market is also a good example of a brokered market. This market contains assets relatively unique and illiquid. Clients generally require the assistance of real estate brokers to find buyers for their home. In these markets, a dealer wouldn't be able to hold an inventory of the asset, like in a quote-driven market, and the illiquidity and low frequency of transactions in the market would make an order-driven market infeasible, as well.

### The Bottom Line

There are different types of market structures simply because traders and investors have different needs. The type of market structure can be very important in determining the overall transaction costs of a large trade. It can also affect the profitability of a trade. In addition, if you are developing trading strategies, sometimes the strategy may not work well across all market structures. Knowledge of these different market structures can help you determine the best market for your trades.

## Article- An Overview of Bull and Bear Markets

By LESLIE KRAMER

Updated Aug 12, 2020

<https://www.investopedia.com/insights/digging-deeper-bull-and-bear-markets/>

In the investing world, the terms "bull" and "bear" are frequently used to describe market conditions. These terms are used to describe how stock markets are doing in general—that is, whether they are appreciating or depreciating in value. And as an investor, the direction of the market is a major force that has a huge impact on your portfolio. So, it's important to understand how each of these market conditions may impact your investments.

### KEY TAKEAWAYS

A bull market is a market that is on the rise and where the economy is sound; while a bear market exists in an economy that is receding, where most stocks are declining in value.

Although some investors can be "bearish," the majority of investors are typically "bullish." The stock market, as a whole, has tended to post positive returns over long time horizons.

A bear market can be more dangerous to invest in, as many equities lose value and prices become volatile.

Since it is hard to time a market bottom, investors may withdraw their money from a bear market and sit on cash until the trend reverses, further sending prices lower.

### Bull Market vs. Bear Market

A bull market is a market that is on the rise and where the conditions of the economy are generally favourable. A bear market exists in an economy that is receding and where most stocks are declining in value. Because the financial markets are greatly influenced by investors' attitudes, these terms also denote how investors feel about the market and the ensuing economic trends.

A bull market is typified by a sustained increase in prices. In the case of equity markets, a bull market denotes a rise in the prices of companies' shares. In such times, investors often have faith that the uptrend will continue over the long term. In this scenario, the country's economy is typically strong and employment levels are high.

By contrast, a bear market is one that is in decline. A market is usually not considered a true "bear" market unless it has fallen 20% or more from recent highs. In a bear market, share prices are continuously dropping. This results in a downward trend that investors believe

will continue; this belief, in turn, perpetuates the downward spiral. During a bear market, the economy slows down and unemployment rises as companies begin laying off workers.

Duration and declines during bear markets.

#### Characteristics of Bull and Bear Markets

Although a bull market or a bear market condition is marked by the direction of stock prices, there are some accompanying characteristics that investors should be aware of.

#### Supply and Demand for Securities

In a bull market, there is strong demand and weak supply for securities. In other words, many investors wish to buy securities but few are willing to sell them. As a result, share prices will rise as investors compete to obtain available equity.

In a bear market, the opposite is true: more people are looking to sell than buy. The demand is significantly lower than supply and, as a result, share prices drop.

#### Investor Psychology

Because the market's behaviour is impacted and determined by how individuals perceive and react to its behaviour, investor psychology and sentiment affect whether the market will rise or fall. Stock market performance and investor psychology are mutually dependent. In a bull market, investors willingly participate in the hope of obtaining a profit.

During a bear market, market sentiment is negative; investors begin to move their money out of equities and into fixed-income securities as they wait for a positive move in the stock market. In sum, the decline in stock market prices shakes investor confidence. This causes investors to keep their money out of the market, which, in turn, causes a general price decline as outflow increases.

#### Change in Economic Activity

Because the businesses whose stocks are trading on the exchanges are participants in the greater economy, the stock market and the economy are strongly linked.

A bear market is associated with a weak economy. Most businesses are unable to record huge profits because consumers are not spending nearly enough. This decline in profits directly affects the way the market values stocks.

In a bull market, the reverse occurs. People have more money to spend and are willing to spend it. This drive and strengthens the economy.

#### Gauging Market Changes

The key determinant of whether the market is bull or bear is not just the market's knee-jerk reaction to a particular event, but how it's performing over the long term. Small movements only represent a short-term trend or a market correction. Whether or not there is going to be a bull market or a bear market can only be determined over a longer time period.

However, not all long movements in the market can be characterized as bull or bear. Sometimes a market may go through a period of stagnation as it tries to find direction. In this case, a series of upward and downward movements would actually cancel-out gains and losses resulting in a flat market trend.

Perfectly timing the market is almost impossible.

### What to Do in Each Market

In a bull market, the ideal thing for an investor to do is to take advantage of rising prices by buying stocks early in the trend (if possible) and then selling them when they have reached their peak.

During the bull market, any losses should be minor and temporary; an investor can typically actively and confidently invest in more equity with a higher probability of making a return.

In a bear market, however, the chance of losses is greater because prices are continually losing value and the end is often not in sight. Even if you do decide to invest with the hope of an upturn, you are likely to take a loss before any turnaround occurs. Thus, most of the profitability can be found in short selling or safer investments, such as fixed-income securities.

An investor may also turn to defensive stocks, whose performance is only minimally impacted by changing trends in the market. Therefore, defensive stocks are stable in both economic gloom and boom cycles. These are industries such as utilities, which are often owned by the government. They are necessities that people buy regardless of the economic condition.

In addition, investors may benefit from taking a short position in a bear market and profiting from falling prices. There are several ways to achieve this including short selling, buying inverse exchange-traded funds (ETFs), or buying put options.

### The Bottom Line

Both bear and bull markets will have a large influence on your investments, so it's a good idea to take some time to determine what the market is doing when making an investment decision. Remember that over the long term, the stock market has always posted a positive return.

## Article- How to Buy Shares on the JSE

Step by Step Guide how to Buy shares on the JSE ( Johannesburg Stock Exchange )

<https://www.sashares.co.za/how-to-buy-shares/#gs.ehct4g>

The Johannesburg Stock Exchange (JSE) is **renowned as the best stock market in Africa**, delivering exceptional returns for investors and traders. However, for people looking to enter the exciting world of trading and investing in **shares**, knowing how to buy JSE shares can be a daunting prospect. If you're one of these people, **follow this step-by-step guide to investing in the JSE for beginners**.

Step 1: Finding the right share to buy

**Buying shares** isn't simply a random process. You'll have to do some solid research to determine which are the **best JSE shares** to buy at the specific time you're looking to **enter into the stock market**. Take note that you can't independently buy shares – you have to find a registered stockbroker who will purchase them on your behalf. But before you get to that stage, it's essential to gain an understanding of the workings of the stock market and the process of buying shares on the JSE. The JSE website has a comprehensive set of free training materials which covers all the jargon associated with JSE stock exchange shares and how to buy JSE shares, so it's recommended that you go through these.

**But how do you go about selecting the best JSE shares to buy?** This largely depends on how much risk you're willing to take, as well as your budget. There are plenty of JSE shares under R10 in price, and these are a good start for new **investors** looking to invest a relatively small amount. You could also decide to invest in penny stocks, which include JSE shares under R1. Unfortunately, if you only have around R1000 to invest, then buying even the cheapest stocks won't be worth it, due to the 10% average cost of brokerage, which will cancel out any **profits**. Realistically, you'll need to start with around R5000 to make the effort worthwhile.

The next logical question is, **what are your investment options on the JSE today?** **Ordinary Shares** are the most common type of shares traded on the stock market. These give you full voting rights at AGMs, as well as **dividends**, while allowing you to benefit from capital growth if the company is doing well. If you choose wisely, by reading through company annual reports, keeping track of market-related news and staying abreast of current affairs, you stand a good chance of gaining inflation-beating returns from ordinary shares.

For the more inexperienced investor, exchange-traded funds (**ETFs**) are also a good option, giving you exposure to a **basket of top performing shares for sale on the JSE**. These save you time and money by enabling investment in a variety of asset classes through a **single listed investment product**. Diversification means that the risk of losing money is less, but the rewards are less too.

For the more inexperienced investor, exchange-traded funds (**ETFs**) are also a good option, giving you exposure to a **basket of top performing shares for sale on the JSE**. These save you time and money by enabling investment in a variety of asset classes through a **single listed investment product**. Diversification means that the risk of losing money is less, but the rewards are less too.

## Step 2: Find a broker or Buy Directly Online

As mentioned previously, you'll need to go through a stockbroker if you want to **buy shares on the JSE**. There are a number of member firms to choose from, and a full list can be viewed on the JSE website. When deciding on a **broker**, you'll want to consider the associated charges, the way you want to trade and what you want to invest in.

Different firms often have different specialities, so make sure that you choose one with good experience in the specific sector you're thinking of investing in. You'll also want to take into account whether you want your **stockbroker to take on a full-service role which includes offering advice and managing your portfolio**, or whether you simply want an 'execution-only' broker who never suggests what to buy or sell, and only acts on your instructions. The first option is obviously far more costly, but advisory brokers can offer some **solid insight into the best JSE shares to buy** and how long to hold onto your shares before selling. With the latter option, you'll generally be able to buy shares online quickly, using the first stockbroker available through your chosen member firm.

Go carefully through the **JSE stockbroker list** and compile a list of three. You can give them each a call if you want to get a general feel for the customer service they offer. At the end of the day, you can have more than one broker and can decide to change brokers if you feel like you're not getting what you need. Of the many **stockbrokers** trading on the **JSE**, around a dozen offer online trading for individual investors, which clients pressed for time will find convenient.

Once you've chosen a broker, you'll be required to fill out some paperwork and sign off on some terms and conditions. Most stockbrokers offer individual investors a logical, easy way to fill out application forms online. **You'll be asked for general client information and residency status, as well as Financial Intelligence Centre Act (FICA) documents including:**

Copy of South African ID, or a Passport if you're a foreign national.

Proof of residence less than three months old, can be a utility bill from where you live. (Alternatively you can provide declaration by a third party confirming you share an address with them).

Copy of a South African Revenue Service (SARS) document confirming income tax number.

Copy of a bank statement (less than three months old) in order to confirm banking details.

### Step 3: Setting up your FREE personal account

**It's almost time to start trading!** After you've submitted all the required paperwork, your stockbroker will call you to officially open your account. This generally requires the **lump sum you wish to invest**, which will be kept in an account called the **JSE Trust Account**. This account ensures that your money is protected if anything happens to your broker. Some brokers will offer you the choice between discretionary and non-discretionary accounts.

Discretionary accounts allow **brokers** to make trades without the consent of the account holder, based on his belief on the best way to achieve investment returns within acceptable levels of risk specified by you. This is a good option for the beginner investors with money to spend and without much inclination to do their own investment research. Non-discretionary accounts have smaller brokerage fees, and with thorough research you'll generally be able to **identify some of the best JSE shares to buy**.

It's usually free to set up an account, and **only a monthly administration fee of between** around R15 and R100 is paid to your **broker**. A common misperception is that stock-monitoring or trading software is required to **invest or trade on the JSE**. This is incorrect, and the JSE does not endorse, sell or authorise any such software. Marketing campaigns often say that these programmes allow for 'direct trade' on the JSE, but this is also false: you can only **invest** on the **JSE** by opening an account with a broker. Most brokers stipulate a minimum amount in your trading accounts when you start out – differing from broker to broker. Remember the R5000 rule if you want to have a realistic chance of receiving returns.

**Once the money to open your account is cleared, you can begin investing in your first shares.**

Once you've chosen a broker, you'll be required to fill out some paperwork and sign off on some terms and conditions. Most stockbrokers offer individual investors a logical, easy way to fill out application forms online. **You'll be asked for general client information and residency status, as well as Financial Intelligence Centre Act (FICA) documents including:**

Copy of South African ID, or a Passport if you're a foreign national.

Proof of residence less than three months old, can be a utility bill from where you live. (Alternatively you can provide declaration by a third party confirming you share an address with them).

Copy of a South African Revenue Service (SARS) document confirming income tax number.

Copy of a bank statement (less than three months old) in order to confirm banking details.

Step 4: Make your first share purchase on the JSE

Discretionary brokers have a **good knowledge of how to buy shares**, and their financial wellbeing is at stake too, so you can usually be assured of some savvy purchases (along with higher commission fees). If you're taking the non-discretionary route, then as a beginner it's recommended that you identify between 4 and 5 different shares to purchase, as this will offer some diversification – important for shielding you from significant dips in any particular market.

This is where the true value of ETFs lies. You're able to set a monthly debit order to purchase these ETFs. By buying ETFs through a **good broker**, having access to brokers' daily reports and taking advantage of the free training courses and educational material offered by most, you'll be able to build up extra knowledge of the stock market until you feel you're ready to venture into the world of **ordinary shares**.

### **Some questions you'll want to ask when deciding on the best South African shares to buy now:**

Do I want to trade or do I want to invest? There's a difference between trading and investing. Trading generally means that you're looking to buy and sell shares on a regular basis, which is generally a high risk, high reward tactic. If you're looking for long-term growth, rather invest in a larger company with a consistent record of steady growth.

Is the share in a high growth sector?

Is the share well priced? The much used adage of 'buy low, sell high' applies here. Cheap isn't always good however, as this could mean that the company is at the start of a long decline. Be sure to do your research.

Is the company's management stable?

### **The value of research cannot be understated. Some indicators to pay attention to:**

Price to Earnings Ratio (P/E). P/E measures how much investors are paying for each rand the company earns. This can be calculated by dividing the company share price by net income. Seasoned investors generally look for undervalued stocks, which have a P/E ratio of around 15 or lower.

Go through the company's quarterly and annual financial reports. Look for a sound history of revenue growth, a solid profit margin and the ability of a company to pay dividends, all of which point to sound financial standing. The share price is likely to be more volatile if the company has a lot of debt.

Be wary of rave reviews. If a wide cross-section of analysts are punting, for example, the best JSE shares to buy in 2017, this likely means that a number of investors will be jumping to buy the stocks, which could over-inflate the price and become difficult to sustain. You could be left with little potential for upside growth in share price.

Expect some volatility. Individual shares are always more volatile than ETFs, so you can expect some swings in share price. It's worthwhile to study full year highs and lows for stocks you're considering to get an idea of how much the prices can swing.

## Conclusion

The *JSE* is an exciting place to invest. However, don't be fooled into thinking it's easy. It's vital to have a good grasp of the workings of the **stock market** and the economy as a whole, as well as the health of the particular markets you're deciding to invest in.

## Article- Commodities Trading: An Overview

<https://www.investopedia.com/investing/commodities-trading-overview/>

Commodities are an important aspect of most South African's daily life. A commodity is a basic good used in commerce that is interchangeable with other goods of the same type. Traditional examples of commodities include grains, gold, beef, oil, and natural gas.

For investors, commodities can be an important way to diversify their portfolio beyond traditional securities. Because the prices of commodities tend to move in opposition to stocks, some investors also rely on commodities during periods of market volatility.

In the past, commodities trading required significant amounts of time, money, and expertise, and was primarily limited to professional traders. Today, there are more options for participating in the commodity markets.

### KEY TAKEAWAYS

Commodities that are traded are typically sorted into four broad categories: metal, energy, livestock and meat, and agricultural.

For investors, commodities can be an important way to diversify their portfolio beyond traditional securities.

In the most basic sense, commodities are known to be risky investment propositions because their market (supply and demand) is impacted by uncertainties that are difficult or impossible to predict, such as unusual weather patterns, epidemics, and disasters both natural and man-made.

There are a number of ways to invest in commodities, such as futures contracts, options, and exchange-traded funds (ETFs).

### A History of Commodities Trading

Trading commodities is an ancient profession with a longer history than the trading of stocks and bonds. The rise of many empires can be directly linked to their ability to create complex trading systems and facilitate the exchange of commodities.

In modern times, commodities are still exchanged throughout the world. A commodities exchange refers both to a physical location where the trading of commodities takes place and to legal entities that have been formed in order to enforce the rules for the trading of standardized commodity contracts and related investment products.

Some commodities exchanges have merged or gone out of business in recent years. The majority of exchanges carry a few different commodities, although some specialize in a single group. In the U.S., there is the Chicago Mercantile Exchange (CME), the New York Mercantile Exchange (NYMEX), the Intercontinental Exchange (ICE) in Atlanta, Georgia, and the Kansas City Board of Trade. In Europe, there is the London Metal Exchange (LME). As its name implies, the London Metal Exchange only deals with metals.

### **Special Characteristics of the Commodities Market**

In the broadest sense, the basic principles of supply and demand are what drive the commodities markets. Changes in supply impact the demand; low supply equals higher prices. So, any major disruptions in the supply of a commodity, such as a widespread health issue that impacts cattle, can lead to a spike in the generally stable and predictable demand for livestock.

Global economic development and technological advances can also impact prices. For example, the emergence of China and India as significant manufacturing players (therefore demanding a higher volume of industrial metals) has contributed to the declining availability of metals, such as steel, for the rest of the world.

### **Types of Commodities**

Commodities that are traded are typically sorted into four categories broad categories: metal, energy, livestock, and meat, and agricultural.

#### **Metals**

Metals commodities include gold, silver, platinum, and copper. During periods of market volatility or bear markets, some investors may decide to invest in precious metals—particularly gold—because of its status as a reliable, dependable metal with real, conveyable value. Investors may also decide to invest in precious metals as a hedge against periods of high inflation or currency devaluation.

#### **Energy**

Energy commodities include crude oil, heating oil, natural gas, and gasoline. Global economic developments and reduced oil outputs from established oil wells around the world have historically led to rising oil prices, as demand for energy-related products has gone up at the same time that oil supplies have dwindled.

Investors who are interested in entering the commodities market in the energy sector should also be aware of how economic downturns, any shifts in production enforced by the

Organization of the Petroleum Exporting Countries (OPEC), and new technological advances in alternative energy sources (wind power, solar energy, biofuel, etc.) that aim to replace crude oil as a primary source of energy, can all have a huge impact on the market prices for commodities in the energy sector.

### **Livestock and Meat**

Livestock and meat commodities include lean hogs, pork bellies, live cattle, and feeder cattle.

### **Agriculture**

Agricultural commodities include corn, soybeans, wheat, rice, cocoa, coffee, cotton, and sugar. In the agricultural sector, grains can be very volatile during the summer months or during any period of weather-related transitions. For investors interested in the agricultural sector, population growth—combined with limited agricultural supply—can provide opportunities for profiting from rising agricultural commodity prices.

### **Using Futures to Invest in Commodities**

One way to invest in commodities is through a futures contract. A futures contract is a legal agreement to buy or sell a particular commodity asset at a predetermined price at a specified time in the future. The buyer of a futures contract is taking on the obligation to buy and receive the underlying commodity when the futures contract expires. The seller of the futures contract is taking on the obligation to provide and deliver the underlying commodity at the contract's expiration date. Futures contracts are available for every category of commodity. Typically, there are two types of investors that participate in the futures markets for commodities: commercial or institutional users of the commodities and speculative investors.

Manufacturers and service providers use futures contracts as part of their budgeting process to normalize expenses and reduce cash flow-related headaches. Manufacturers and service providers that rely on commodities for their production process may take a position in the commodities markets as a way of reducing their risk of financial loss due to a change in price.

The airline sector is an example of a large industry that must secure massive amounts of fuel at stable prices for planning purposes. Because of this need, airline companies engage in hedging with futures contracts. Future contracts allow airline companies to purchase fuel at fixed rates for a specified period of time. This way, they can avoid any volatility in the market for crude oil and gasoline.

Farming cooperatives also utilize futures contracts. Without the ability to hedge with futures contracts, any volatility in the commodities market has the potential to bankrupt

businesses that require a relative level of predictability in the prices of goods in order to manage their operating expenses.

Speculative investors also participate in the futures markets for commodities. Speculators are sophisticated investors or traders who purchase assets for short periods of time and employ certain strategies as a way of profiting from changes in the asset's price. Speculative investors hope to profit from changes in the price of the futures contract. Because they do not rely on the actual goods they are speculating on in order to maintain their business operations (like an airline company actually relies on fuel), speculators typically close out their positions before the futures contract is due. As a result, they may never take actual delivery of the commodity itself.

If you do not have a broker that also trades futures contracts, you may be required to open a new brokerage account. Investors are also typically required to fill out a form that acknowledges that they understand the risks associated with futures trading. Futures contracts will require a different minimum deposit depending on the broker, and the value of your account will increase or decrease with the value of the contract. If the value of the contract decreases, you may be subject to a margin call and required to deposit more money into your account in order to keep the position open. Due to the high level of leverage, small price movements in commodities can result in either large returns or large losses; a futures account can be wiped out or doubled in a matter of minutes.

There are many advantages of futures contracts as one method of participating in the commodities market. Analysis can be easier because it's a pure play on the underlying commodity. There's also the potential for huge profits, and if you are able to open a minimum-deposit account, you can control full-size contracts (that otherwise may be difficult to afford). Finally, it's easy to take long or short positions on futures contracts.

Because the markets can be very volatile, direct investment in commodity futures contracts can be very risky, especially for inexperienced investors. The downside of there being a huge potential for profit is that losses also have the potential to be magnified; if a trade goes against you, you could lose your initial deposit (and more) before you have time to close your position.

Most futures contracts offer the possibility of purchasing options. Futures options can be a lower-risk way to enter the futures markets. One way of thinking about buying options is that it is similar to putting a deposit on something instead of purchasing it outright. With an option, you have the right—but not the obligation—to follow through on the transaction when the contract expires. Therefore, if the price of the futures contract doesn't move in the direction you anticipated, you have limited your loss to the cost of the option you purchased.

### **Using Stocks to Invest in Commodities**

Many investors who are interested in entering the market for a particular commodity will invest in stocks of companies that are related to a commodity in some way. For example, investors interested in the oil industry can invest in oil drilling companies, refineries, tanker companies, or diversified oil companies. For those interested in the gold sector, some options are purchasing stocks of mining companies, smelters, refineries, or any firm that deals with bullion.

Stocks are typically thought to be less prone to volatile price swings than futures contracts. Stocks can be easier to buy, hold, trade, and track. Plus, it is possible to narrow investments to a particular sector. Of course, investors need to do some research to help ensure that a particular company is both a good investment and commodity play.

Investors can also purchase options on stocks. Similar to options on futures contracts, options on stocks require a smaller investment than buying stocks directly. So, while your risk when investing in a stock option may be limited to the cost of the option, the price movement of a commodity may not directly mirror the price movement of the stock of a company with a related investment.

An advantage of investing in stocks in order to enter the commodities market is that trading is easier because most investors already have a brokerage account. Public information about a company's financial situation is readily available for investors to access, and stocks are often highly liquid.

There are some relative disadvantages to investing in stocks as a way of gaining access to the commodities market. Stocks are never a pure play on commodity prices. In addition, the price of a stock may be influenced by company-related factors that have nothing to do with the value of the related commodity that the investor is trying to track.

### **Using ETFs and Notes to Invest in Commodities**

Exchange-traded funds (ETFs) and exchange-traded notes (ETNs) are an additional option for investors who are interested in entering the commodities market. ETFs and ETNs trade like stocks and allow investors to potentially profit from fluctuations in commodity prices without investing directly in futures contracts.

Commodity ETFs usually track the price of a particular commodity—or group of commodities that comprise an index—by using futures contracts. Sometimes investors will back the ETF with the actual commodity held in storage. ETNs are unsecured debt securities designed to mimic the price fluctuation of a particular commodity or commodity index. ETNs are backed by the issuer. ETFs and ETNs allow investors to participate in the price fluctuation of a commodity or basket of commodities, but they typically do not require a special brokerage account. There are also no management or redemption fees with ETFs and ETNs because

they trade like stocks. However, not all commodities have ETFs or ETNs that are associated with them.

*BAL: iPath Bloomberg Cotton Subindex Total Return ETN; CAFE: iPath Pure Beta Coffee ETN; NIB: iPath Bloomberg Cocoa Subindex Total Return ETN*

Another downside for investors is that a big move in the price of the commodity may not be reflected point-for-point by the underlying ETF or ETN. In addition, ETNs specifically have credit risk associated with them since they are backed by the issuer.

*CORN: Teucrium Corn Fund; SOYB: Teucrium Soybean Fund; WEAT: Teucrium Wheat Fund*

### **Using Mutual and Index Funds to Invest in Commodities**

While you cannot use mutual funds to invest directly in commodities, mutual funds can be invested in stocks of companies involved in commodity-related industries, such as energy, agriculture, or mining. Like the stocks they invest in, the shares of the mutual fund may be impacted by factors other than the fluctuating prices of the commodity, including general stock market fluctuations and company-specific factors.

However, there are a small number of commodity index mutual funds that invest in futures contracts and commodity-linked derivative investments, and therefore provide investors with more direct exposure to commodity prices.

By investing in mutual funds, investors get the benefit of professional money management, added diversification, and liquidity. Unfortunately, sometimes management fees are high, and some of the funds may have sale charges.

### **Using Commodity Pools and Managed Futures to Invest in Commodities**

A commodity pool operator (CPO) is a person (or limited partnership) that gathers money from investors and then combines it into one pool in order to invest that money in futures contracts and options. CPOs distribute periodic account statements, as well as annual financial reports. They are also required to keep strict records of all investors, transactions, and any additional pools they may be operating.<sup>1</sup>

CPOs will usually employ a commodity trading advisor (CTA) to advise them on trading decisions for the pool. CTAs must be registered with the Commodity Futures Trading Commission (CFTC) and are usually required to get a background check before they can provide investment advice.<sup>2,3</sup>

Investors may decide to participate in a CPO because they have the added benefit of receiving professional advice from a CTA. In addition, a pooled structure provides more money and more opportunities for the manager to invest. If investors choose a closed fund, all investors will be required to contribute the same amount of money.

### **The Bottom Line**

Both novice and experienced traders have a variety of different options for investing in financial instruments that give them access to the commodity markets. While commodity futures contracts provide the most direct way to participate in the price movements of the industry, there are additional types of investments with less risk that also provide sufficient opportunities for commodities exposure.

In the most basic sense, commodities are known to be risky investment propositions because they can be affected by uncertainties that are difficult, if not impossible, to predict, such as unusual weather patterns, epidemics, and disasters both natural and man-made.

## Article- Buying Property in South Africa

<https://africa.com/a-basic-guide-to-investing-in-property-in-south-africa/>

A quick drive around South Africa's major cities such as Johannesburg, Cape Town, and Pretoria reveals one unmissable feature: amid shiny, high-rise buildings, towering cranes compete for attention as they transport hefty loads up and down new under construction buildings. It's a familiar sight that greets you in many metros across the continent. The growth of Africa's cities is driving demand for more commercial and residential property.

For **South Africa**, this growth has persisted for years as the country's urban middle class expands, creating a need for new houses, shopping malls, and office blocks. Despite the Southern African nation's current economic and political distress, real estate remains an attractive opportunity for investors.

Before you jump at the opportunity to invest in property in South Africa, here's a quick guide to help you prepare for your venture.

### Consider Buying to Let

The buy-to-let strategy is one of the easiest ways to invest in property. It's no wonder it seems to be a favourite for many investors in the South African real estate market. While it has its risks, like any other strategy, purchasing property to rent out is a sound investment choice whose benefits far outweigh its shortcomings. One person who believes in this strategy is Jason Lee, the best-selling author of *Making Money Out of Property in South Africa*, and two other property books.

*"Buy-to-let properties make fantastic retirement products if you buy right and have patience. The tenants contribute or cover your mortgage payments so they essentially pay for or assist in paying for an asset that you own,"* Lee shares.

He adds, *“Over time, the balance on your mortgage becomes lower while the value and rental income from the property increases. This gives you options in retirement. You can either sell the property to access the capital gain or keep the property and collect cash flow in the form of monthly rent payments.”*

Before you commit to buying property, it’s important to calculate the potential yield on the property. You can simply do this by calculating the annual rental income minus expenses – such as maintenance – and divide it by the price you pay for the property. Also, find out the yield of other rental properties in the same area to avoid paying an unfair price for the property. Doing sufficient research can mean the difference between having a sound investment and a botched venture.

When buying property to rent out, one other key factor to consider is housing affordability, says Lee. *“Affordability is always an issue and that is why I like to concentrate on the middle-income bracket that low income buyers can aspire to and high-income buyers can downsize to,”* he explains.

### Choose the Type of Property That Delivers Best Returns

If you’re looking for an investment opportunity in the residential market, it’s always critical to know which types of property are best performers. In South Africa, data reveals that one bedroom and studio apartments have been the best-performing for over 12 years. Investors who choose a one-bedroom apartment receive better returns than those who invest in a two or three-bedroom flat. However, more South Africans continue to purchase two-bedroom apartments despite lower returns.

One-bedroom apartments are entry-level choices for most young professional first-time home buyers, says CEO of Landsdowner Investment Properties, Jonathan Kohler. *“The thinking behind this is that two people could rent the property together or two people could perhaps purchase the property. However, this has simply not been the case, and investors in this market are not reaching their maximum return. Investors looking to purchase a property must keep two of the key principles in mind – rental return and capital appreciation,”* explains Kohler.

*“Whether you’re a student, living away from home for the first time, a young professional renting your first apartment that you’re paying for yourself, a first-time homeowner or a first-time investment property buyer with buy-to-let aspirations, the one-bed-one bath is generally a good place to start,”* says Kohler

To illustrate the different returns investors fetch from the different apartments, Kohler uses the example of two apartments located in the same complex in Johannesburg’s northern suburbs. If you buy a one-bedroom ground floor apartment for R740,000 (US \$57,045), you can receive up to R7,000 (US \$540) a month in rent and spend roughly R977 (US \$75) on

levies and R320 (US \$25) on rates. You can expect this apartment to appreciate at 8% per annum, which means you could get a net rental return of 9.25% per annum, a remarkable overall return on investment of 17.25%.

On the other hand, a two-bedroom ground-floor apartment that costs about R980,000 (US \$75,538) would bring you about R8,250 (US \$636) in monthly rental fees. It would cost you R1,50 (US \$127) and R420 (US \$32) in levies and rates respectively – bringing you a rental return of 7.25% per annum and a total return on investment of 15.25%.

It's All About Location!

As the saying goes, *“The three most important aspects of real estate are location, location, location!”* It's vital to ensure the property you're buying is in a desirable place to keep its resale value rising. The location is also a determining factor in how long a property takes to sell.

In South Africa, the Western Cape province continues to outperform all other areas, with Cape Town remaining the most lucrative city in the country. The strength of its housing market and house price inflation, which has risen by over 10.35%, make the Mother City an attractive property investment destination for investors.

Several factors make the coastal province king of South Africa's property market. Dr. Andrew Golding, Chief Executive of the Pam Golding Property Group, explains: *“The outperformance of the Western Cape housing market relative to both Gauteng and KwaZulu-Natal began in mid-2013 – which more or less coincides with the start of the “semigration” of buyers to the Cape. Factors fuelling movement to the Cape – the appeal of a proven record of service delivery, access to excellent schooling and the attractive lifestyle – are showing no signs of slowing down.”*

Dr. Golding adds: *“Over and above this Cape Town metro trend, buyers relocating to the Western Cape are also settling in other urban areas such as Paarl, Somerset West and Stellenbosch, as well as along the coastline. A further noteworthy trend is an ongoing increased demand for agricultural property for lifestyle as well as for commercial use. Most sought-after among lifestyle buyers are small scale (8-20ha) farms in the Elgin and Grabouw Valley priced between R7 million and R20 million.”*

While Cape Town ranks as the most expensive city in the country, there are still some areas where you can find a good deal. These include the likes of Goodwood, Richwood, Bothasig, Edgemoor, and Monte Vista.

Residential Property Remains Strong in South Africa

The question of whether to invest in residential or commercial property can be a tricky one, especially if you're not armed with information to back your decision. While both property types offer different advantages and disadvantages, residential real estate remains sturdy in South Africa. It's also the better option for the less experienced investor with limited property experience.

However, while residential property retains a positive outlook, its performance is slowing down thanks to consumers' wavering sentiments. Properties are remaining longer on the market, with this year's average being 15 weeks compared to 11 weeks in 2016 – according to South African bank, Absa. The bank also reports a drop in 2017's asking prices, with 92% of the houses selling below market price versus 2016's 88%. This may prove to be a good time for foreign investors to enter the South African market.

In fact, recent years have seen the country attract more foreign direct investment into property. In 2014, R9,7 billion worth of foreign investment poured into the economy. The depreciation of the South African rand over the past two years has also made the country's real estate more attractive to foreign investors.

#### Listed Property Is an Alternative

If you're looking to invest in real estate but don't want to deal with the rigours of managing tenants, listed property is the route to go. Instead of buying physical property, you can simply put some money into a property fund, which invests in publicly-listed real estate companies.

The advantage of a property fund is that it exposes you a diversity of assets, including residential, industrial, retail properties. By investing in a fund, you can have stocks in different properties types such as shopping malls, office blocks, and townhouses.

*"For a small investor, a buy-to-let property comes with a concentration of risk. You are spending a huge amount of money on one single asset and if the tenant goes wrong, you take a big financial knock,"* explains John Loos, household and property sector strategist at FNB Home Loans. *"Yes, the share market can be volatile, but if you bought into one listed property fund, you have already spread your risk into a number of properties, so the concentration risk isn't nearly as much as with a buy-to-let property."*

South Africa boasts numerous real estate funds that have dominated the unit trust space over the last ten years. Some of the country's top-performing property funds are the Absa Property Equity Fund (which was awarded the 2017 Raging Bull Award for Best South African Real Estate Fund), Stanlib Property Income Fund, and Prudential Enhanced SA Property Tracker Fund. There's also Catalyst SA Property Equity Prescient Fund, Investment Solutions Property Equity Fund, and many others.

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Article: How to navigate the many investment vehicles

And why it's important to consult an independent financial advisor on your savings goals.

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