UNDERSTANDING INVESTMENTS

A. INTRODUCTION

All investments are not equal, and knowing, why investing, what to invest in, when to invest in it and how much to invest are important questions to answer. This section is designed to provide some basic guidelines to help, but we advise you seek professional advice before investing.

i) Savings versus Investments

Savings represent that part of the person's income which is not used for consumption. Saving is a passive activity and is more focused on safety of principal (the amount you start out with) and less concerned with return. Savings are put in the safest of places or products that ensure that you can access your funds anytime. Savings products include a savings account with a bank or certificates of deposits. The flexibility of the products, i.e. funds are accessible any time and safety of the principal amount entails that returns are generally lower.

Investing is the proactive use of your money to make more money. When you invest though, there is a great risk of losing your money than when you save. However, you could earn substantially more through investing. Investing requires a longer period than for savings. Due to the longer investment period, Funds meant for investments should be in excess of provisions made for emergencies. Simply put, you should invest so that your money grows and shields you against future risks. People can invest in different investment vehicles such as buying shares, bonds or unit trusts.

ii) Why should you invest?

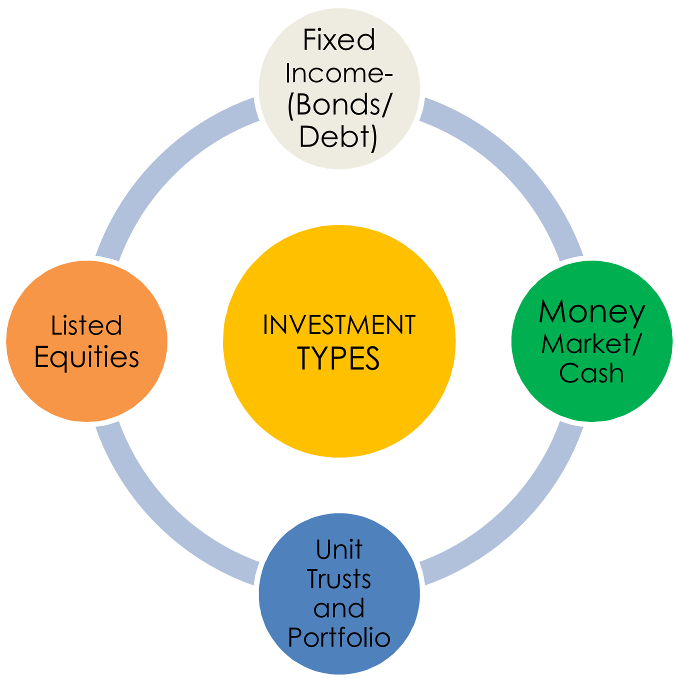
There are several reasons for investments and these are very clear and simple as summarised below;

- To meet future needs such as buying a house and payment for College fees;
- Preservation of value for example guard against inflation;

- To earn a profit;
- To protect against unexpected events for example to cover for extra medical costs;
- To raise capital for starting or expanding a business; and/ or
- To grow your money for example the return allows your money to build, creating wealth over time

B. TYPES OF INVESTMENTS (ASSET CLASSES)

Investment types consist of a group of securities with varying degrees of risk. The diagram below shows the four main asset classes of investments available on the local market:



Each investment type consists of different investment characteristics, such as the level of risk and potential for delivering returns and performance in different market conditions:

1. Listed Equities

An equity/share/stock represents a form of ownership. The holder of such a share is a member of the company and has voting rights. Equities (also known as 'ordinary shares' or 'shares') are issued by a public limited company, and are traded on a Securities Exchange /Stock Market, for example the Zimbabwe Stock Exchange (ZSE) or the Financial Securities Exchange (FINSEC). Equities or shares represent a claim to a company's assets (everything the company owns including buildings, equipment and trademarks) and earnings (all of the money the company makes after meeting all obligations). Apart from risk characteristics the essential characteristic of a share is ownership and upside potential.

1.1 Ownership

When you buy a stock, you are buying a piece of a company and you become a part owner. You are regarded as a shareholder or stockholder. This ownership gives you certain rights, including voting on important matters before the company and participating in the profits if the company distributes dividends. Most people associate owning a company to having to go to work and overseeing operations like what a sole proprietor does. When you buy a share you become an owner and the company appoints a board of directors who safeguard your interest (with management who runs the company accounting to the board) as you pursue other interests.

1.2 How do you make money from shares?

When you own stock, you participate in the growth of the company. As the value of the company increases, so does your investment. There are mainly two ways of how shareholders are rewarded for owning shares in a company which are:

i. **Share price increase** – This refers to the increase in the value of your investment. This is the difference between the sell price and purchase price. For example, if you buy one Innscor share for 71 cents and after sometime the price goes to 90 cents you would have made a 27% gain. The growth in the value of a business comes from growth in its sales and profits. This growth is the one reflected in the price increase.

ii. **Dividend payments** – This is a payment made by a company to its shareholders as a distribution of profits. Dividends are an important portion of the investment return. Companies balance the cash they retain in the business to finance growth and the cash paid to shareholders to reward them for investing.

For example suppose Simbisa Brands which owns Chicken Inn outlets introduces a 4 Piecer with a spice that is well received by masses of people, the company will have more chicken sales and profits will surge. If profits increase, you may receive more dividends and/or the price of the stock increases such that you sell at a profit (i.e. higher than you would have bought the stock price for).

NB: Examples given are for illustration purposes only and are not intended to advertise or influence the share price of any listed entity

To determine whether a stock is cheap or expensive so that you can buy or sell the stock is not necessarily easy and requires the services of professionals in that field. There are many strategies that are employed to benefit from a stock price increase or a stock price decrease and these require the services of investment management professionals.

1.3 So where are Shares bought and sold?

Like the market for tomatoes, shares are also bought and sold on a market called the Securities/Stock Exchange. Locally, we have the Zimbabwe Stock Exchange (ZSE) and Financial Securities Exchange (FINSEC) where company shares are bought or sold. Only licensed Securities Dealers/ Stockbrokers or Asset Managers (through stockbrokers) are allowed to buy and sell shares on the Stock Exchanges. Anyone interested in trading shares on the Stock Exchanges places his/her orders (buy or sell orders) with Stockbrokers or Asset Managers.

1.4 Why do companies end up listed on the Securities/Stock Exchange?

- **Raise Capital** - A business owner can start off small and raise cash from family and friends. However as the operations expand the business owner might require large sums of money like a million dollars. The stock exchange is where companies being listed for the first time (a process known as initial public offer) raise cash to invest in plant and equipment to increase production.

Subsequently the company can raise more money by issuing shares through a process called a rights offer.

- **Exit Strategy** - An Initial Public Offering is often used as a strategy by founders to exit the company or sell some percentage of the company in order to make money and sometimes to reduce the risk of losing it all.

- **Raising the company profile** – The visibility that comes along with a successful listing on a stock exchange can increase the firm's brand value and act as a marketing tool. The fact that a firm exposes itself to public scrutiny can be interpreted as a commitment by management to perform well and such scrutiny can help it borrow funds in the debt market.

1.5 How is Trading in shares conducted?

Trading can be conducted through the following summarised steps:

i. Select the stocks you want to buy e.g. Econet, Delta, Seed Co etc. This can be done through getting advice from licenced professionals.
ii. Open a personal bank account with any local bank.
iii. Approach a Stockbroker and open a Securities Trading Account.
iv. Once accounts have been opened, deposit/ Transfer funds into the account provided by the Stockbroker.
v. Instruct broker to purchase the number of shares of a company of your choice that you want to buy.
vi. The broker will execute the purchase on your behalf and when the purchase has taken place, you will be notified.
vii. An electronic share certificate will be issued out to you via the Scrip Custodian in step iv.

1.6 Functions of the Stock Market

- **Mobilization of savings**

  Stock exchanges play an important role in mobilizing savings of individuals and institutions. Savings mobilized can be utilized to invest in various projects, thus, boosting industrial and economic development of a country.

- **Raising Capital**

  If you are starting a company you might look for funding from people who would want to be part of your business (mobilised savings). People will buy a share of your business in turn giving you the funding to buy the requisite equipment. Raising capital is important for industrial development and the economic growth of a country

- **Providing Liquidity**

  Stock exchanges provide liquidity to investors. They serve as a platform where buyers and sellers of securities come into contact to buy and sell securities. Therefore any person who owns a security can sell his security in a stock exchange and convert into cash. Thus, wealth is created when one buys low and sells high.

- **Economic Indicator**

  The stock market is a leading indicator meaning people buy shares when the economy is expected to do well in the future. Hence, the performance of the stock market should ordinarily tell you where the economy is going. However, there are times when the economy is not rational and no link can be traced between future economic growth and the performance of the stock market.

- **Attracting foreign investment**

  Stock exchanges aid in attracting foreign investment. They attract foreign money which can be used in the Banking sector. The presence of foreign participation also serves as an indicator of the conduciveness of doing business in a country

1.7 Stock Market Investment Risks.

- **Returns are not guaranteed** – There's no guarantee you'll make money on a stock at any given point in time. Although a number of things can help you assess a stock, no one can predict exactly how a stock will perform in the future. There's no guarantee prices will go up or that the company will pay dividends. Or that a company will even stay in business.

- **You may lose money** – Stock prices can change often and for many reasons. You have to be comfortable with the risk that you might lose most of your money when you buy and sell stocks, especially if you're not planning to invest for the long term.
- **Long term perspective** – it is always necessary to maintain a long term perspective on investments. Research has shown that stock markets go through many cycles; however the securities tend to perform better than bonds and money market investment over long periods. A disciplined and long term perspective has high chances of paying off a good reward.

2. Fixed Income Securities Investments

Perhaps the easiest way to think of fixed income/ bonds/debenture is as a loan. They're issued by companies and governments as a way of raising money. Bonds provide a regular stream of income (which is normally a fixed amount paid at regular intervals) over a specific period of time, and promise to return investors their capital on a set date in the futures when the bond matures or becomes due. Bonds can offer stable returns, and are perceived to be lower risk than equities – although they typically deliver lower returns over the long-term.

Investing in fixed interest securities issued by companies other than those issued or guaranteed by certain governments, exposes investors to greater risk of default in the repayment of the capital provided to the company or interest payments due to the fund. Bonds are generally long-term in nature that is, greater than one year as opposed to money market which is less than one year.

2.1 What are the basic types of Bonds?

We have 3 common types of bonds namely:-

- Government Bonds/Treasury Bonds- bonds issued by Government through the Central Bank
- Municipal Bonds/Quasi- Government Bonds – Bonds issued by Municipalities or State enterprises
- Corporate Bonds- Bonds issued by private enterprises

2.2 Who are the participants in the Bond market?

- Government and Quasi-Government institutions
- Corporates
- Banks
- Individuals
- Institutions e.g. Asset Management Companies
- Pension Funds

2.3 Why do Companies/Government float Bonds in the market?

Government and Companies use proceeds from bond sales for a wide variety of purposes such as:

- Infrastructure and new equipment purchase
- Refinancing debt
- Financing mergers and acquisitions
- Financing any projects of a long term nature

2.4 Basic Bond terminology.

2.4.1 What is a Coupon?

Periodic income received by the bondholder during the time between when the bond is issued and when it matures.

2.4.2 What is a bond price?

The amount one pays to buy a bond. The price is normally calculated from the coupons of a bond and a discount rate (yield rate). The actual mathematics of pricing a bond will be examined in a different section.

2.4.3 What is a bond yield?

The money that investors earn on a bond during the life of a bond from the date of purchase up to maturity of the bond.

2.5 How do you earn a return from investing in bonds?

- Increase in bond price e.g. an investor can buy a bond at a price of $101 and sell it at $105 in the process earning a profit of $4

- Coupon payments- an investor only earns this coupon during the period in which they are holding the bond.

For further information on bond trading strategies, please refer to Securities Market Intermediaries e.g. Asset Managers

2.6 Why invest in bonds?

The main reason is that unlike equities, bonds provide a regular long-term income stream which can be comfortable for retirees or other investors who need predictable source of income.

Other advantages include investment diversification, which can reduce risk or improve a portfolio's overall rate of return, because with bonds as an anchor for a portfolio, an investor may feel more comfortable taking on greater risk with other investible assets in the hope of achieving greater return.

2.7 The difference between bonds and shares

When one invest in bonds, all the investor receives is interest and the principal amount on the bond no matter how profitable the company becomes. In the event of liquidation, bondholders are paid first before shareholders.

2.8 Bond Ratings

A bond rating is the grade given to the company that issues a bond on its ability to pay the bond principal and the interest. The bond rating is done by rating agencies such as Standard & Poor's, Fitch, Moody's or Global Credit Rating Agency.

2.9 What are some of the risks of investing in bonds?

- **Default Risk:** - the company may fail to make timely payments of interest or principal to the bondholder. Thus the ability of a company to pay its debt obligations on time should be of important concern to bondholders.
- **Interest rate risk**: - the price of a bond will fall if the market interest rate rises. If the price falls below what investors paid on purchasing the bond, investors can incur a loss.
- **Inflation risk**: - Inflation is a general rise in the prices of goods and services, which causes a decline in purchasing power. Inflation often causes the

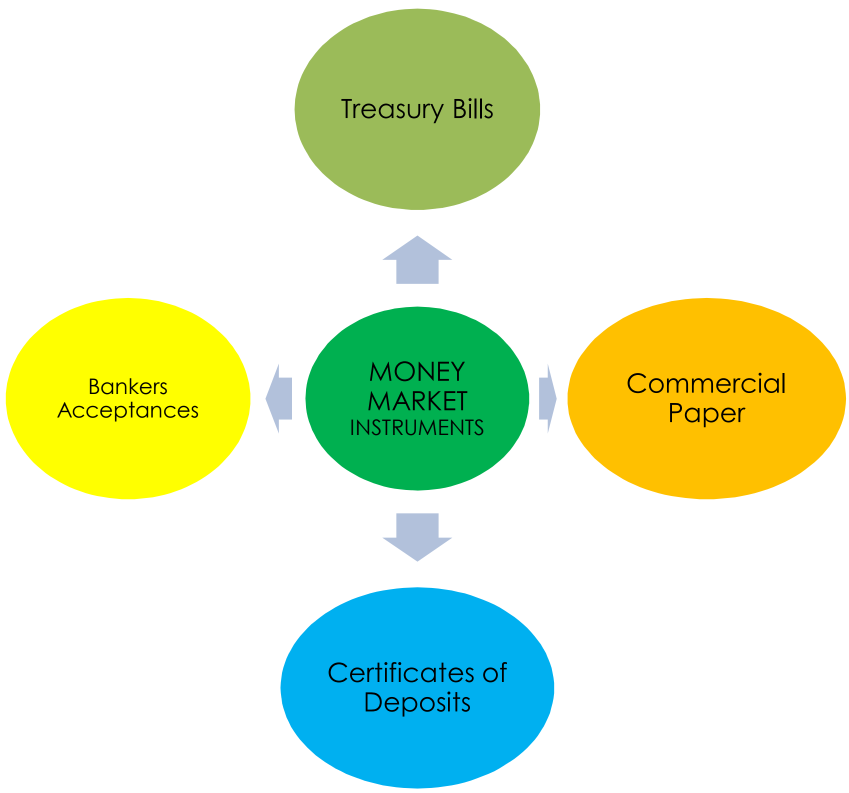
government to increase interest rates so as to control demand for credit (which fuels inflation). Interest rate rise causes bond prices to fall.

- **Liquidity risk: -** the risk that the investors seeking to sell their bonds may not receive a price that reflects the true value of the bonds (based on the bond's interest rate and creditworthiness of the company).
- **Call risk**: - the terms of some bonds give the company the right to buy back the bond before maturity date.

3. Money Market/ Cash Investments

Money market means a market where short-term securities of tenure of less than one year are traded. In these investment forms, both individual and institutional investors deposit their funds in anticipation of interest returns whilst also being able to withdraw their funds in the short term. Money market investments can be as short as overnight placements or for placement periods such as: 7 days; 14 days; 30 days; 60 days or 90 days.

3.1 Examples of Money Market Instruments



3.2 Money Market Participants

- Banks
- Insurance Companies
- Building Societies
- Asset Management Companies
- Government
- Corporate entities
- Individuals

3.3 Why investing in Money Market

- Regular interest income
- No transaction fees for entry and exit
- Tax advantages if the instrument is tax free
- Protects against portfolio volatility
- Highly liquid

3.5 Disadvantages of Money Market Investments

- Low returns
- Slow capital appreciation

3.6 How do you earn a return when investing in Money Market?

The key source of return in a money market instrument is accrued interest, which is either earned on maturity of the instrument or when the instrument is disposed before maturity.

For further information on money trading strategies, please refer to Securities Market Intermediaries e.g. Asset Managers

4. Unit Trust Investments and Portfolio Investments

Investing directly into different assets can become costly and difficult to manage particularly for small investors. Unit Trusts or Collective investment schemes allow investors to pool together their contributions, and to share the costs and benefits of investing.

Each individual investor then has an indirect or direct claim on the assets purchased, subject to fees levied by the intermediary. Investment usually involves diversification of assets in order to avoid unnecessary and unproductive risk.

Unit trusts are established when a registered Fund Manager accepts or pools money from small investors and invests it in shares, bonds, money market or other securities under a trust deed.

A trust is created by a legal document called "trust deed" prepared by a legal representative who outlines the purpose of the trust, the rights and obligations of the trustees and unit holders, powers of the trustee, and identifies various parties such as initial unit holders and Trustee(s).

4.1 Types of Unit trusts fund

- Money Market- funds invested in money market
- Bond Fund- funds invested in bonds
- Equities Fund-funds invested in shares
- Hybrid Fund- funds invested in both money market, bonds and shares

In Zimbabwe Unit Trusts are regulated through the Collective Investment Schemes Act.

C. SOURCES OF INFORMATION FOR INVESTMENTS

- Company Annual reports
- Company Results Briefings and Presentations
- Company Websites and Social Media Pages
- Industry Reports
- Regulatory bodies – e.g. Potraz, RBZ to get information on competitive analyses
- Regulatory filings e.g. Tax returns and filings to the SECZ.
- Stock exchanges and data vendors to get past stock prices and other important metrics
- Publicly available information e.g. qualitative information on leadership quality and company corporate governance.

D. RISK / RETURN RELATIONSHIPS

Risk Return Matrix

The risk matrix below is based on the long run relationships of risk and return. Investment is putting money into something with the expectation of gain, usually over a longer term. Investment has a connotation of a long-term holding period, in contrast to speculation or gambling, which is the purchase of assets seeking profit from short-term price movements. Hence, in the short term the relationship below may not hold;

Investment	**Risks**	**Potential Return**
Money Market	Low	Low
Bonds	Low to moderate	Low to moderate
Equities	High	Moderate to high