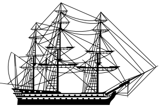


Vanguard®

Equity investing

Plain Talk® Library

Contents

Introducing equities	5
Types of equities	6
The lowdown on equities	9
How to invest in equities	13
High risk, high (potential) returns	16
Three lessons for equity investing	19
How equities fit into your portfolio	21
Vanguard’s investment principles	22
The Vanguard difference	24

Introducing equities

When you invest in equities—also known as stocks, shares or securities—you're typically buying an ownership stake in a listed company. This means you become a shareholder and have claim to the company's assets and earnings. These companies can be listed on stock exchanges around the world—in developed and emerging markets.

There are country exchanges like the Australian Securities Exchange (ASX) and the New York Stock Exchange (NYSE), and there are also exchanges which specialise in particular industries, like the NASDAQ with technology.

This Plain Talk® guide explains how equities work, how to invest in the equity market and how equities can take their place in a diversified portfolio to help build your long-term wealth.

Types of equities

There are thousands of stocks listed on the world's stock exchanges, ranging from blue-chip shares issued by multinationals with established track records to small-cap shares issued by local companies and start-ups raising capital through initial public offerings.

Australian shares

Investing in domestic equities can be a good place to start when building your share portfolio. You can benefit from a more intimate knowledge of the local market. Australian shares can also offer tax advantages as many listed Australian companies issue franking credits that investors can use to offset the income tax they pay on their dividends.

Keep in mind though that the Australian sharemarket only accounts for 3% of the world's total share market and is heavily skewed towards resources and finance companies. Investing purely in domestic equities could mean you struggle to build a truly diversified portfolio. Confining yourself to domestic equities could mean missing out on a whole world of potential returns.

International shares

It's a big world out there. Whether it's a Silicon Valley technology company, a German automobile manufacturer, a French insurer, a Swiss chocolate maker or a Chinese bank, international shares can give your investment portfolio diversification across more industries, more market sectors and more economies.

But international equities do come with potential risks.

- Currency risk: Your investment could lose value if the Australian dollar appreciates against other currencies if you are not hedging against currency exposure.
- Political risk: Your investment could be jeopardised if there are legislative changes or political upheaval in countries which may not be as stable as Australia.
- Tax risk: Your tax position could be complicated when selling or receiving dividends from international shares.

And it can be time-consuming and expensive to build and keep track of an international portfolio.

One solution is investing in an exchange traded fund (ETF) or managed fund which can provide access to thousands of stocks in just a few simple trades.

Smart investing tip 1: Invest overseas

Investing internationally can increase your diversification further and give you access to different industries and companies not in Australia. After all, Australia represents less than 3% of the total world sharemarket.

The lowdown on equities

When you buy shares directly, you are in full control of your investment. You decide when to buy and you decide when to sell. While you hold the shares, you can receive income in the form of dividends. And when you sell you'll receive a potential capital gain if the company's share price increases in value. Unlike bond investing, equity trading is via a regulated exchange such as the Australian Securities Exchange (ASX).

The role of the ASX

The ASX is one of the world's leading financial market exchanges. It provides a market for people to buy and sell shares in the companies listed on it. The role of the ASX is to enable business owners to raise capital from the general public by issuing tradable securities, and to facilitate a secondary market for those securities where investors can trade with other investors.

Pricing

A company's share price reflects supply and demand. If there are more people looking to buy than sell a company's shares, it's a seller's market and the share price will go up. But if there are more people looking to sell than buy, it's a buyer's market and the share price will fall.

Smart investing tip 2: Decide whether to invest inside or outside super

Super offers a tax-effective investment framework, where contributions, earnings and withdrawals receive favourable tax treatment. But remember, you won't be able to access your funds until you reach preservation age.

Investors don't always react rationally to market developments. As history tells us, fear and greed can play a significant role in daily market movements.

At times, speculative investors drive share prices to unsustainable levels, only to come undone when the market corrects itself. At other times, nervous investors can react with a herd mentality to media headlines and sell assets off in haste without appreciating their underlying worth, only to miss out on the subsequent rebound.

On any given day share prices can be influenced by a number of factors, including:

- interest rate decisions
- inflation changes
- company profits, performance and dividends
- foreign exchange fluctuations.

Benefits of share investing

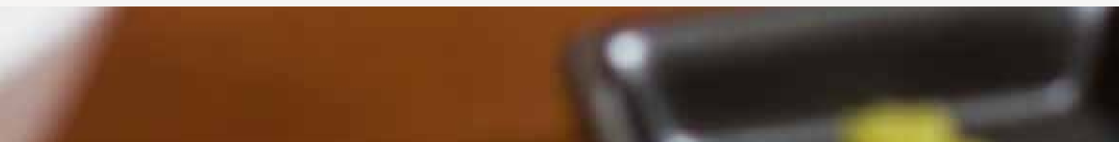
- You can enjoy a potential capital gain.
- You can receive income from dividends.
- You can potentially reduce the amount of tax you pay with franked dividends from Australian shares.
- You may be eligible for tax benefits arising from a discount on capital gains when you sell shares that you've held for more than 12 months.

Risks of share investing

- You can lose your capital if the share price falls.
- You can't rely on dividends as a regular source of income as market conditions change.
- You are the last creditor to be paid if the company goes under.

Smart investing tip 3: Invest long term

People often get caught up with short-term stock selection, which can deliver inconsistent results. While one investment might deliver great returns one year, it is difficult to pick winners every year. When it comes to investing, it generally pays to diversify and invest for the long term.



How to invest in equities

You can invest in the sharemarket in a variety of ways.

Stockbrokers

You can buy and sell shares through a stockbroker. An online broker will typically charge you a set fee per transaction. A full service broker can give you advice and recommend which shares to buy, usually for a percentage of the sale. Here are some of the factors your broker will take into account when looking at which shares to invest in.

- Share price: The amount you will pay for each share in the company. Shares listed on the ASX can range from blue-chip shares like the big four banks to companies whose shares are only worth a few cents.
- Market capitalisation: The total value of all the company's shares tells you the size of the company. Stocks can range from small-capitalisation shares, which may be a more speculative investment, to global giants like Apple, whose market capitalisation reached $US775 billion in 2015.
- Dividend history: The regularity with which the company has issued dividends. Some companies deliver regular income to their shareholders in the form of dividends. Other companies tend to reinvest their profits in the business and rely more on delivering capital growth to shareholders.
- Dividend yield: The dividend per share divided by the share price. While high dividends usually reflect healthy profits, it's worth checking that they come from profits rather than borrowings.

Managed funds

You can buy units in a managed fund which gives you access to a broad range of equities and increased diversification. You benefit from professional expertise. Remember, managed funds charge fees to invest and these fees can vary widely. Vanguard's managed funds have among the lowest fees in the industry.

- Index or passive managers aim to closely track market returns.
- Active managers aim to beat the return of a market index or benchmark.

Exchange traded funds (ETFs)

ETFs are traded on the stock exchange. Similar to an index managed fund, an index ETF is made up of a collection of holdings in different companies that when combined together replicate an index such as the ASX 300, S&P 500 or FTSE 100. ETFs can offer investors diversification without needing to buy each share individually. Index-based ETFs are generally a low-cost investment, and substantially lower in cost than investing in the same exposure of individually purchased shares. But remember, fees apply. Like a managed fund, an equity ETF can be a cost-effective way of gaining broad market coverage.

Listed investment companies (LICs)

LICs enable you to invest in a range of assets and pay you dividends. LICs in Australia primarily invest in Australian or international shares and offer you exposure to the same universe of assets that can be accessed through many unlisted managed funds. But again, fees apply.

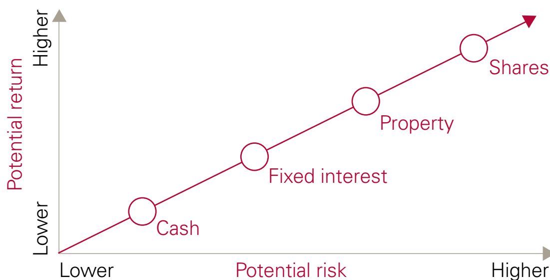
When you invest in a managed fund, ETF or LIC you aren't buying shares directly. You're buying exposure units in the fund or company, which owns the shares on behalf of unitholders. This can lead to a disconnect between the value of the holdings and the value of the units in the LIC.

High risk, high (potential) returns

Equities are also referred to as growth assets. Growth assets like shares are riskier than defensive assets like cash and fixed income but offer higher potential returns. So when you invest in the sharemarket, you are taking a higher risk for a higher potential return.

You can reduce your risk by including other asset classes in your portfolio to offset the impact of any downturn in share prices.

The risk spectrum



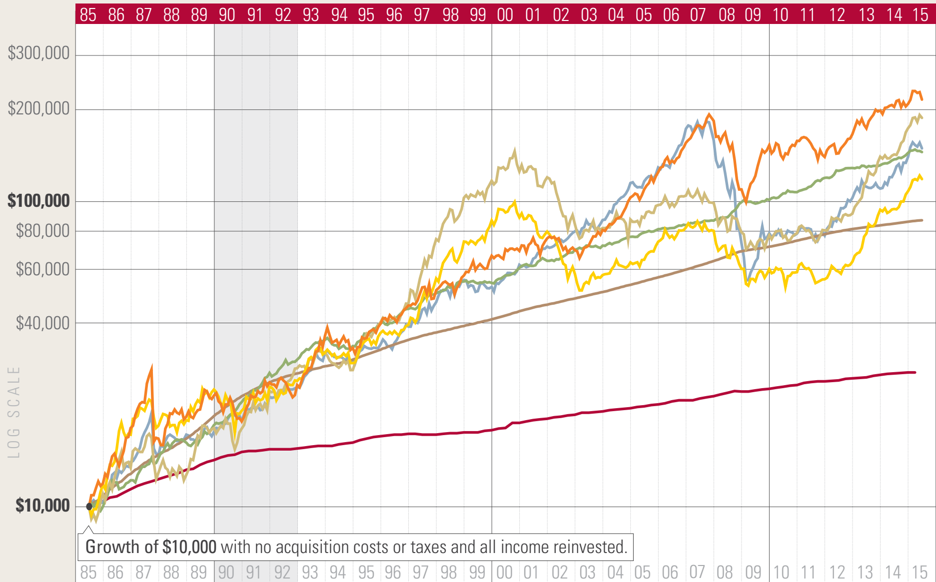
Invest for the long term

It's very difficult to predict daily share price fluctuations. Even professional traders find it difficult to make money by trading shares regularly as the price of individual companies can fluctuate dramatically from day to day.

As you can see in Vanguard's 2015 Index Chart on the next page, history tells us that despite bumps along the way, investors who have the patience and discipline to stay the course can be well rewarded over the long term. If you hold a broad range of quality shares across a diversified group of industries and countries, you put yourself in the best position to build your wealth over the long term.

The value of long-term investing

Financial year total returns for the major asset classes for financial years ending between 1985 and 2015.



Percentage returns (%) as at 30 June 2015[1]

	1 Year	5 Years	10 Years	20 Years	30 Years
Australian Shares[2]	5.7	9.4	7.0	9.4	10.8
International Shares[3]	25.2	15.4	6.3	6.2	8.6
US Shares[4]	31.8	19.8	7.8	8.5	10.3
Australian Bonds[5]	5.6	6.4	6.3	7.1	9.3
Listed Property[6]	20.3	14.3	2.5	7.8	9.4
Cash[7]	2.6	3.6	4.7	5.2	7.5
CPI[8] (to March 2015)	1.3	2.3	2.7	2.6	3.5

Australian Recessions[9]

Sources: Australian Bureau of Statistics, ASX Limited, Bloomberg Finance L.P., Commonwealth Bank of Australia, Melbourne Institute of Applied Economic & Social Research, MSCI Inc., Reserve Bank of Australia, Standard & Poor's, Thompson Reuters. Notes: 1. One-year returns are total returns from 1 July 2014 to 30 June 2015. 5, 10, 20 and 30 year returns are average annual compound returns to 30 June 2015. 2. S&P/ASX All Ordinaries Accumulation Index. 3. MSCI World ex-Australia Net Total Return Index. 4. S&P500 Total Return Index. 5. Prior to December 1989 the index is the Commonwealth Bank All Series Greater Than 10 years Bond Accumulation Index. From September 1989 the index is the Bloomberg AusBond Composite 0+ Yr Index. 6. S&P/ASX 200 A-REIT Accumulation Index. 7. Data prior to March 1987 supplied by Reserve Bank of Australia. From March 1987 the index is the Bloomberg AusBond Bank Bill Index. 8. ABS Consumer Price Index (to March 2015). 9. Recessions as defined by the Melbourne Institute of Applied Economic and Social Research. 10. Annualised Rate of Inflation. All figures are Australian dollars. 11. Interest Rate is the Reserve Bank of Australia's Official Cash Rate. All marks are the exclusive property of their respective owners. Disclaimer: The information contained herein is intended for informational purposes only. It is not intended as investment advice, and must not be relied upon as such. No responsibility is accepted for inaccuracies. Past performance does not guarantee future returns.©2015 Vanguard Investments Australia Ltd. (ABN 72 072 881 086 / AFS Licence 227263). All rights reserved. Vanguard Investments Australia Ltd pays a subscription fee to Andex Charts Pty Ltd. Past performance is not an indicator of future performance.
© Copyright 2015 Andex Charts Pty Ltd. Reproduction either in whole or in part is expressly prohibited without the written permission of Andex Charts Pty Ltd.

Three lessons for equity investing

1. It's time in the market, not timing the market

Long-term investing isn't about chasing the hottest performing shares. It's about taking a long-term view and staying the course. It won't protect you from market downturns, but it ensures you are 'in the market' during times of growth.

2. Market downturns are part of investing

Over the past 50 years, the Australian sharemarket has experienced a downturn once every five years on average—as defined by a negative return at the end of the year. It's difficult to predict the timing of poor markets and also upturn markets (sometime referred to as bull markets) and investors need to be aware of the extent to which share prices can change. The big danger is that you panic and sell at or near the bottom of the downturn and miss out on the subsequent recovery, as many investors did during the Global Financial Crisis (GFC) in 2008 and 2009.

3. Sharemarkets can be volatile

When times are good and returns are positive, many investors forget that shares can go down as well as up. The longer you have to invest, the less you need to worry about short-term volatility.

Over time, the ups and downs of investment markets tend to even out and the gap between the highest and lowest returns may close. So it's important to think about how long you have to invest when choosing your investments.

How equities fit into your portfolio

Equities provide the best opportunity for growth over the long term, but can carry the risk of market volatility. It's important to align the amount of growth assets included in your portfolio to your objective, as excluding growth assets from your portfolio could be detrimental to building your wealth in the long term. Remember inflation can impact the purchasing power of your money over time so including growth assets can help reduce the impact of rising prices.

The importance of advice

Whether you're planning to invest in the sharemarket directly, through your super or via a managed fund, a professional financial adviser can help you develop and maintain a diversified portfolio to help you achieve your long-term goals.

Smart investing tip 4: Don't lose sight of your long-term objectives

Remember why you are investing. Markets can go up and they can go down over the shorter term, so try and focus on your long-term goals and stay the course.

Vanguard's investment principles

Successful investing in equities—as with all other assets—hinges on many factors. Some can't be controlled, like market returns. But others can be. Vanguard believes that following these four principles will allow you to focus on the factors within your control, which can be an effective way to achieve long-term results.

1. Create clear, appropriate investment goals

Investors should set measurable and attainable investment goals, develop plans for reaching those goals and regularly evaluate their plans.

Investors with multiple goals like retirement planning and saving for a child's education should have a separate plan for each.

Without a plan, investors commonly construct their portfolios from the bottom up, paying more attention to choosing and buying investment products than to achieving their goals. Investors without a plan often construct their portfolios by evaluating the merits of each investment individually. If the evaluation is positive, they add the investment to their portfolio, often without considering whether it fits. This process can lead to a mismatch between the portfolio and its objectives. Common and avoidable mistakes include performance chasing and market timing.

2. Develop a suitable asset allocation using broadly diversified funds

A successful investment strategy starts with an asset allocation suitable for its objective. Investors should establish an asset allocation using reasonable expectations for risk and returns. The use of diversified investments helps to limit exposure to unnecessary risks.

When developing their portfolios, investors should select the combination of equities, bonds and other investments offering the best chance for success. This top-down asset allocation decision is among the most important factors in determining whether investors meet their objectives.

3. Minimise cost

While you can't control the markets, you can control how much you are willing to pay. Every dollar that you pay for management fees or trading commissions is a dollar less of potential return. Lower-cost investments tend to outperform higher-cost alternatives in the long term.

4. Maintain perspective and long-term discipline

Investing can evoke emotion that disrupts the plans of even the most sophisticated investors. Some make rash decisions based on market volatility, but investors can counter that emotion with discipline and a long-term perspective.

Rebalancing should be done on a regular basis. This will bring your portfolio back inline with the asset allocation you originally established to meet your objectives.

When equities are performing poorly, you may naturally be reluctant to sell other assets like bond funds that are performing well and buy more equity funds. But the worst market declines can lead to the best buying opportunities. If you don't rebalance your portfolio during these difficult times you may be jeopardising your long-term investment goals.

Smart investing tip 5: Don't chase performance

Don't just choose investments because their recent performance looks good or they promise substantial tax breaks. Make sure the investments you choose are aligned to your investment objectives and earn their place in your portfolio.

The Vanguard difference

When you invest with Vanguard, you have more than 40 years of investing experience behind you. So no matter which investment products suit your needs, you can feel confident that Vanguard investments are built on a rigorous investment philosophy that stands the test of time.

Since launching the first index mutual fund for individual investors in 1976, Vanguard has strived to be the world's highest-value provider of investment products and services. We have an unwavering focus on our clients with a commitment to champion what's best for investors by offering outstanding service, while keeping costs low.

Low-cost investing

We know we can't control the markets, but we can control the costs of investing. To that end, providing low-cost investments isn't a pricing strategy for us. It's how we do business.

We can keep our costs low because of our unique ownership structure in the United States, which allows us to return profits to investors through lower costs so investors can earn more over time.

Our range of managed funds and ETFs

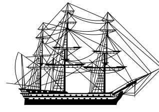
Vanguard offers a complete range of funds across all asset classes.

To see our complete product offerings, visit vanguard.com.au.

This page has been intentionaly left blank.

This page has been intentionaly left blank.

This page has been intentionaly left blank.



Vanguard®

Connect with Vanguard™

vanguard.com.au

1300 655 101

This material contains general information and is intended to assist you. Vanguard Investments Australia Ltd (ABN 72 072 881 086 / AFS Licence 227263) is the product issuer. We have not taken your circumstances into account when preparing this material so it may not be applicable to your circumstances. You should consider your circumstances and our Product Disclosure Statements ("PDSs") before making any investment decision. You can access our PDSs at vanguard.com.au or by calling 1300 655 101. Past performance is not an indication of future performance. This material was prepared in good faith and we accept no liability for any errors or omissions.

© 2016 Vanguard Investments Australia Ltd.
All rights reserved.

PTGEI_042016